The Economist

SEPTEMBER 4TH–10TH 2004 www.economist.com

The Republicans in New York
PAGE 27

Women and reproductive health
PAGES 24–26

Decision time on Iran
PAGES 14 AND 23–26

Keep prostitution legal
PAGES 12 AND 53

Ripe for revolution

A special 14-page report on cars and their makers

PRINT EDITION

Full contents
Enlarge current cover
Past issues/regional covers
Subscribe

GLOBAL AGENDA

POLITICS THIS WEEK

BUSINESS THIS WEEK

OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds

ONLINE FEATURES
Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

The Economist Group
Economist Intelligence Unit
Economist Conferences
The World In
Intelligent Life
CFO
Roll Call
European Voice
EuroFinance Conferences

Print Edition — September 4th 2004

Ripe for revolution
New kinds of cars are about to produce a new kind of car industry ... More on this week's lead article

Previous print editions

Aug 28th 2004
Aug 21st 2004
Aug 14th 2004
Aug 7th 2004
Jul 31st 2004

More print editions and covers »

Subscribe

Subscribe to the print edition
Or buy a Web subscription for full access online
RSS feeds
Receive this page by RSS feed

The world this week

Politics this week
Business this week

Leaders

Car manufacturing
Ripe for revolution

Prostitution
Sex is their business

Those Olympic Games
A matter of priorities

Brazil and Argentina
To Lula's credit

Iran
Decision time approaches

Mobile telecoms
The lessons of 3G

Letters

On secessionist statelets, Deutsche Bank, Nigeria, African scams, journalists

Special Report

Defiant Iran
The world of the ideologues

United States

The Republican convention
Grinding out a victory

New York's protests
What are they fighting for?

The electoral week
On the trail

Spying for Israel
A mole in the Pentagon

Arab-Americans
Turning away

Arms control
Don't trust, don't verify

Campaign finance
The rise and rise of 527s

Lexington
The other president

The Americas

Public spending in Brazil
Bloated, wasteful, rigid and unfair

By invitation
What really happened in Venezuela?

Politics in Mexico
Campaigning as a blood sport

Asia

Malaysia
The freeing of Anwar

India's opposition
Flagging enthusiasm

Japan and Russia
North or south?

Corruption in China

A survey of the car industry

Perpetual motion
Detroit's nine lives
The new European order
Here be dragons
Fighting back
Clean machine
Driving change
Sources
Offer to readers

Business

Bloomberg
Missing Mike

Corporate scandals
The chronicles of greed

French business
Fiscal favours

Beer in Russia
Beyond vodka

Microsoft
Bug trouble

Electricity in Japan
A healthy jolt

Coal-fired electricity
The future is clean

Face value
Two Hartz beat as one

Special Report

Mobile 3G telecoms
Vision, meet reality

Finance & Economics

Japan Post
Ready, steady, go

Apology: Temasek

The battle for UFJ
Deals on wheels

Trade politics
Byrd-brained

Long-Term Capital Management
Taxing the ghost

American banks
Smart liquidation

Outsourcing to India
Safety matters

Fuel-oil futures in China
Step by step

Economics focus

Economist Diaries and Business Gifts

Advertisement

Shooting the messenger

China
The road to Beijing

Australia calls an election
The truth game

Middle East & Africa

Iraq
Can Muqtada al-Sadr now become a peaceful politician?

Israel and Palestine
The return of the suicide-bombers

Angola
The long slow walk to normality

Equatorial Guinea
Will the "coup plot" thicken?

Europe

France
A tragic twist of the scarf

Terror in Russia
No end to it

Turkey
A Kurd on the rise

German think-tanks
Pennies for their thoughts

Charlemagne
I understand, up to a point

Britain

Prostitution
It's a foreigner's game

Importing policies
Swedish message

Asylum
From flood to trickle

Urban music and gays
MOBO phobic

House prices and the economy
Fasten your seatbelts

Northern Ireland
It's not much, but it's progress

Hospital infections
Superbug scare

Bagehot
Growing apart

Articles flagged with this icon are printed only in the British edition of *The Economist*

A future meltdown?

Science & Technology

Reproductive health
Ten years' hard labour

Genital mutilation
The unkindest cut for a woman

Books & Arts

Shakespeare
Will o' the wisp

Christopher Marlowe
An imaginary life

Bad leaders
The neglected art of followership

Antonio Stradivari
Lord of the strings

New fiction
Room with a point of view

Worldwide bestsellers
The big book index

Obituary

Obituary
Elisabeth Kübler-Ross

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Top universities

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

The Economist commodity price index

Emerging-Market Indicators

Overview

Inflation rates

Economy

Financial markets

Advertisement

Classifieds

Jobs
Pre-press Technician
Based: Central London The Economist Newspaper is seeking a Pre-press Technician to join the ....

Business / Consumer
WSI Internet - Start Your Own Business
Business Opportunity - WSI Internet Start Your Own Busines....

Tenders
Republic of Ghana Ministry of Trade, Industry, PSD & PSI - Request for Expression of Interest: Preparation of Competition Bill for Ghana

Jobs
Lead Economist
The Social Protection and Labor Sector (HDNSP) contributes to The World Bank's mission of pov....

Tenders
Requests Expressions of Interest for The Development of a New Lignite Mining Facility and Associated New Electric Generating and Transmission

Jobs
Energy Analyst
International Energy Forum Secretariat (IEFS) Riyadh, Saudi Arabia The I....

Sponsors' feature About sponsorship »

About Economist.com | About *The Economist* | About Global Agenda | Media Directory | Staff Books | Advertising info | Career opportunities | Contact us

Copyright © The Economist Newspaper Limited 2006. All rights reserved. Advertising Info | Legal disclaimer | Accessibility | Privacy policy | Terms & Conditions | Help

Produced by =ECO PDF TEAM=
Thanks xxmama

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Politics this week

Sep 2nd 2004
From The Economist print edition

Held hostage

AP

At least eight people were killed when a gang of men and women took about 350 hostages at a school in the **Russian** region of North Ossetia, near Chechnya. The hostage-takers threatened to kill 50 children if any member of their gang was slain and are demanding the withdrawal of Russian troops from Chechnya. A suicide attack at a Moscow metro station killed nine people and the bomber.

See article

Slobodan Milosevic began his own legal defence by describing his war-crimes trial as a farce. But the UN tribunal in the Hague imposed a defence lawyer on the former **Yugoslav** president after deciding that he was too ill to represent himself. Meanwhile a Bosnian-Serb politician, Radislav Brdjanin, was sentenced to 32 years in jail by the court for his role in ethnic cleansing.

The government of **Macedonia** bowed to huge popular pressure and agreed to schedule a referendum on a law that would give more power to the ethnic-Albanian minority. President Branko Crvenkovski said the referendum should not lead to renewed fighting.

The bombers return

Two **Palestinian** suicide-bombers killed at least 16 Israelis by blowing up two buses almost simultaneously in Beersheba, in the Negev desert, the first such atrocity since March. The Israeli government promised retribution, while its prime minister, Ariel Sharon, struggled to sustain his plan to evacuate Jewish settlers from the Gaza strip in the face of opposition from within his own Likud party.

See article

A truce between **Iraq's** American-backed interim government and the rebel Shia cleric, Muqtada al-Sadr, arranged through the offices of Grand Ayatollah Ali al-Sistani, was holding after three weeks of fighting; Mr Sadr was said to be thinking of embarking on electoral politics.

See article

Iraq's Sunni insurgents showed no such inclination, slaughtering a dozen **Nepalese** cooks and cleaners, to scare off foreign workers, and threatening to kill two French journalists unless France changed its law banning girls from wearing headscarves at school—something Jacques Chirac refuses to do, though he sent his foreign minister round the Arab world to plead for the journalists' lives. Pope John Paul and Muslim leaders in several countries also asked for mercy.

See article

A report for the UN Security Council concluded that Sudan's government had failed to disarm Arab militias or halt attacks on civilians in the western region of **Darfur**, as it was required to by August 29th. But Russia, a veto-wielding permanent member of the council, said it was not the time to impose sanctions.

Zimbabwe's tobacco crop, traditionally its main export, fell for the fourth year in a row, to a quarter of

the output before President Robert Mugabe started confiscating white-owned farms in 2000.

Anwar freed

AP

Anwar Ibrahim, the former deputy prime minister of **Malaysia**, was freed, six years after his arrest.

See article

South Korea told the International Atomic Energy Agency that four years ago some of its scientists, acting without government knowledge, used laser technology to enrich a tiny amount of uranium almost to bomb-grade. An earlier nuclear programme had been shut down under American pressure. The admission is bound to complicate six-way talks aimed at halting North Korea's bomb-building.

A group of 29 people claiming to be **North Korean** defectors forced their way into a Japanese school in Beijing. South Korea seemed willing to accept them as refugees.

Taiwan cancelled a military exercise due to take place next month after China abandoned similar manoeuvres. The decision is likely to lessen tension across the Taiwan strait.

At least three Americans and three Afghans were killed in an explosion outside the offices of an American security firm in Kabul, the capital of **Afghanistan**.

The **Australian** government called a general election for October 9th.

See article

A convention in town

AP

The **Republican Party**, holding its convention in New York City, anointed George Bush as its presidential candidate and applauded Dick Cheney as his running-mate. Meanwhile, hundreds of thousands of New Yorkers took to the streets to protest.

See article

Lawrence Franklin, a mid-level Defence Department official specialising in Iran, was revealed to be under investigation by the FBI for allegedly passing documents to **Israel**.

See article

In the Republican primary for the Senate race in **Florida**, Mel Martinez, Mr Bush's preferred candidate, beat Bill McCollum, whom he labelled a “darling of the homosexual extremists” for supporting a hate-crime bill.

Prosecutors dropped charges of sexual assault against **Kobe Bryant**, a basketball star, because the alleged victim refused to testify.

The debt collector calls

Rodrigo Rato made his first visit since taking over as the IMF's managing director to **Argentina**, the Fund's top problem debtor. He told President Néstor Kirchner that Argentina should raise its fiscal surplus; Mr Kirchner said his country wants to postpone some debt payments due to the Fund this year.

Andrés Manuel López Obrador, the leftish mayor of Mexico City, kicked off his campaign for **Mexico's** presidency in 2006 with a huge rally in the capital. He is fighting a government-inspired effort to prosecute him for an administrative violation and thus bar him from standing.

See article

Martín Torrijos, the son of a former dictator and national hero, was sworn in as **Panama's** president. He said that he would seek to re-establish full diplomatic relations with Cuba, broken last week after his predecessor pardoned four Cuban exiles jailed for a foiled attempt to assassinate Fidel Castro during a summit meeting in Panama in 2000.

Colombia's Constitutional Court struck down a controversial anti-terrorism law that would have allowed the security forces to tap phones and make arrests without warrants. President Álvaro Uribe's government said it might send the bill to Congress again; critics say the measures are unnecessary.

After **Chile's** Supreme Court ruled by a narrow majority that General Augusto Pinochet did not enjoy immunity from prosecution, a judge said that he planned to question the former dictator about human-rights abuses.

Staring into space

Three separate groups of European and American scientists found three **planets** that are roughly the size of Neptune orbiting nearby stars. These are the first planets found outside the solar system that are probably made of ice and rock rather than hot gas.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Business this week

Sep 2nd 2004
From The Economist print edition

Chronicle of greed

AP

Hollinger International, which recently sold Britain's *Daily Telegraph*, accused Lord Black and other former bosses of “lining their pockets” to the tune of $400m and treating the firm as a “cash cow to be milked”. Lord Black, who was forced out as CEO last November, dismissed the allegations. Hollinger is seeking $1.25 billion from Lord Black and others through the courts.

See article

Eliot Spitzer, New York's business-bashing attorney-general, promised to keep a close eye on **GlaxoSmithKline** to ensure that it adheres to the terms of a $2.5m settlement for suppressing negative results in clinical trials. Mr Spitzer described the British drug giant as “arrogant” for its dismissive attitude toward his lawsuit; GSK accused him of “bullying”.

Kevin Hannon, chief operating officer of **Enron's** broadband-internet unit, agreed to plead guilty to a single conspiracy charge and to assist prosecutors to build cases against the top bosses of the failed energy giant.

Trade weighted

The World Trade Organisation ruled that the European Union, Japan, Canada and Brazil may impose trade sanctions worth hundreds of millions of dollars against the United States. America has not repealed the **Byrd amendment**, which obliges the distribution of cash raised in anti-dumping duties on foreign firms to home companies that are deemed to have suffered as a result. The measure was declared illegal by the WTO in 2002, but has wide political backing in America.

See article

America's trade policy also came under fire from NAFTA. A panel ruled for the third time in Canada's favour in a dispute over **softwood**. NAFTA insisted that Canadian lumber imports did not constitute a threat to America's wood companies and ordered an end to duties that have raised $2.7 billion over the past two years. NAFTA rules still allow America to launch a last “extraordinary challenge” to the latest ruling.

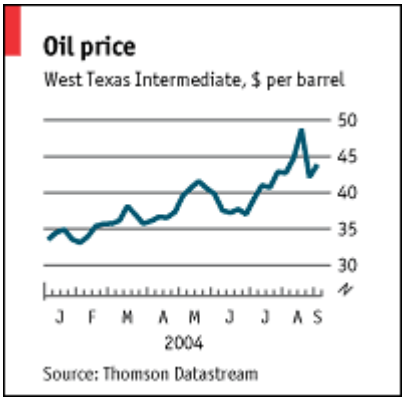
India endeavoured to grab a bigger slice of world trade. The country's government unveiled plans for tax concessions to exporters and the creation of free-trade zones to attract foreign investment. India hopes to double its share of global trade by 2009.

In a blow to the world's gourmands, CITES, the UN agency that controls trade in endangered species, has called a halt to **caviar** exports. Producers, mainly based around the Caspian sea, have failed to comply with an agreement signed in 2001 to protect sturgeon. The countries, including Russia, Iran and Azerbaijan, need permits from CITES to export the fish eggs. But poaching is likely to remain rife.

Slippery slopes

The **oil** price fell to its lowest level for a month. Russia's promise to

increase output by 7% this year and news that exports from Iraq were unaffected by troubles in the south of the country helped to ease concerns. But prices shot up again after America revealed an unexpectedly large decline in stocks.



National Grid Transco, Britain's biggest gas distributor, sold four of its distribution networks for £5.8 billion ($10.4 billion) to consortia that include other big utilities. Transco, which remains as Britain's largest gas distributor, will return cash to shareholders and pay hefty debts.

Flying out the door

Over 7,000 jobs could go at **Alitalia**, nearly a third of the workforce, according to unions at the embattled Italian airline. The carrier faces bankruptcy unless it can get access to a loan of *euro*400m ($487m) which is contingent on its pushing through cost cuts.

As talks on slashing costs between **United Airlines** and its unions continued, reports emerged that the American carrier was considering more drastic surgery to escape bankruptcy: 6,000 job losses, some 10% of the workforce.

Capital gain

UBS agreed to pay $265m to acquire the capital-markets unit of **Charles Schwab**, which itself bought the business some eight months ago for $321m. The purchase will beef up the giant Swiss bank's presence in America by making it the second-biggest trader of NASDAQ-listed shares. For Charles Schwab, it marks part of a retreat to its core business as America's leading discount brokerage.

J.P. Morgan Chase was reportedly in talks to create a joint-venture with **Cazenove**, the City of London's leading independent investment bank and broker to many of Britain's biggest firms. Cazenove is also considering a stockmarket flotation.

The French government said that it would sell up to 12.1% of **France Telecom** to raise as much as *euro*5.8 billion ($7.1 billion) towards reducing public debt—a rare example of money making a return journey to the French taxpayer from a nationalised industry. The sale will reduce the state's stake to just over 40%, in effect privatising the company, though the government said that it would remain as a big shareholder in France Telecom for some time.

The world's biggest online auctioneer, **eBay**, pressed ahead with its plans to remain at the top. It offered $530m to take full control of its South Korean affiliate, **Internet Auction**. The American firm now has operations in 29 countries and continues to eye online-auction sites in places where it has yet to establish a foothold.

An American appeals court reversed a decision by a lower court and has allowed shareholders in **Oracle** to sue the business-software maker and its chief executive, Larry Ellison, for allegedly covering up losses in 2000 and 2001. Oracle denies the charges.

Losing confidence

Americans showed concern about the future state of the economy. **Consumer confidence** slumped in August after four months of gains, according to the Conference Board. A fragile jobs market and a high oil price turned former optimism into wariness about future trends.

August proved a dismal month for **America's big carmakers**. General Motors reported that sales had slumped by 14% compared with a year ago, Ford said that it had sold 13% fewer vehicles and DaimlerChrysler was 6% down. Their big Japanese rivals, Toyota and Honda, also had a bad month, but some smaller firms, including Nissan and Volvo, sold more cars.

See article

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Car manufacturing

Ripe for revolution

Sep 2nd 2004
From The Economist print edition

New kinds of cars are about to produce a new kind of car industry

AMERICANS are queuing up to add a Prius, a new petrol-electric hybrid car, to the trio of gas-guzzlers parked in the average suburban driveway. There is no doubt about it: this car is cool. It is not only fashionable in the usual way—the favourite model of Hollywood movie stars—but also in a new and startling manner. The Prius serves not only as a green credential for its owner, but also as an exciting high-tech gizmo. Yet for anyone watching the fortunes of the car industry closely, the Prius represents something else as well—the quiet revolution that is about to engulf the car industry itself.

Leading that revolution is Toyota, manufacturer of the Prius. It is no accident that Toyota, Japan's biggest car firm, is now pioneering the industry's move into new kinds of environmentally friendly vehicles with a cleverly marketed and commercially viable product. Toyota is a relentless competitor which has overtaken Ford in terms of sales and is now tailgating the industry's leader, General Motors (GM). The widespread use of all-electric, non-polluting vehicles, using hydrogen fuel-cell systems (like GM's concept car above), is probably still 20 years away. The Prius, with its little electric motor performing as a supplement to its petrol engine, is just a small step in that direction. But it is significant, because it represents two things that promise to transform the entire car industry—new technology and new production methods.

So last century

The car business is ripe for revolution. As our survey of the industry in this issue describes, it has chronic problems. Once it epitomised 20th-century capitalism, but today it looks poorly equipped to thrive in the 21st century, or even to survive in its present form. Many of the world's biggest car firms are destroying wealth rather than creating it. About half of the industry is regularly incapable of earning a decent return on its invested capital. Although it still accounts for about a tenth of economic activity in rich countries, it has been virtually shut out of stockmarkets for the past 20 years, accounting for a mere 1% of total market capitalisation.

Only the support of governments and the patience of founding families keep many companies going. Even this has often not made car making profitable. For years companies such as General Motors and Ford have relied on their finance arms to stay afloat. Laden with gold-plated pension and health schemes from an earlier, more profitable age, Detroit sometimes seems like a Swedish-style welfare state paid for by a consumer-finance business specialising in cars. This is unsustainable. Long-term liabilities are being

met by repeated financing via the corporate bond market, the only part of the capital markets that most car companies can tap.

But there are plenty of ideas knocking around for how the industry might transform its fortunes. Ambitious mergers are no longer regarded as the answer, especially after the disastrous acquisition of Chrysler by Daimler-Benz in 1998. Instead, the focus is on ways to adapt the mass production system invented by Henry Ford to the realities of today's markets. All car firms have learned from Toyota how to use just-in-time, lean production to make cars much more efficiently. A continuous flow of parts arrives from the other side of the world (increasingly from China) just when they are needed. But, oddly, the finished cars then sit in parking lots for up to 90 days before they are sold, usually at a discount because they are not the colour or do not have the optional extras that the buyer wants. The whole industry is straining to find ways of making cars to order rather than producing them for inventory.

The industry is also trying to respond to changing tastes. As consumers become more choosy, the market is fragmenting into a bewildering array of niches. As a result, car manufacturers are struggling to make their assembly lines flexible enough to produce, say, roadsters in the morning and pick-ups in the afternoon. But as the market fragments, flexibility alone may not be enough. Smaller production runs, smaller factories and new ways of assembling cars are likely to be needed as well. Henry Ford could one day be history, to borrow one of his own famous put-downs. Economies of scale alone used to dictate the industry's shape, but changing markets could be more conducive to smaller, less capital-intensive companies.

Such changes are already lowering the barriers to entry to new entrants. Some parts suppliers have taken over the role of final assembly of niche models for big car firms, and others are doing more of the development work on new cars. The virtual car company could be in sight: perhaps one day some firms will own only technology, design and a brand, while a contract-manufacturing industry, born of today's suppliers, springs up, a path already taken by the consumer electronics and computer industries.

Also pushing the car industry in this direction is the fact that cars themselves are evolving into something akin to consumer electronics products, and this trend is likely to accelerate. Cars are already lighter than they were, and they contain growing numbers of chips and other electronic gear. Luxury models have features such as adaptive cruise control that keeps drivers from hitting the car in front. Electronic controls and little electric motors could soon be providing steering and braking as well, much as they do in aircraft. As electronics replaces clutches, steering boxes and other mechanical features, cars will become still lighter.

Thrill me

Those firms slow to innovate will surely exhaust even the patience of protective governments and founding families, and so fade away. Those that are successful at coping with the big technological, marketing and financial changes beginning to sweep the car industry, as Toyota has so far shown itself to be, should survive. But for the next few decades they, too, will have to scramble to adapt. And the car industry's privileged status as the pre-eminent example of the power of mass production looks finished. The industry of the future will look more like other consumer products businesses—crowded, fast-moving and a slave to the whims of customers.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Prostitution

Sex is their business

Sep 2nd 2004
From The Economist print edition

Attitudes to commercial sex are hardening. But tougher laws are wrong in both principle and practice

TWO adults enter a room, agree a price, and have sex. Has either committed a crime? Common sense suggests not: sex is not illegal in itself, and the fact that money has changed hands does not turn a private act into a social menace. If both parties consent, it is hard to see how either is a victim. But prostitution has rarely been treated as just another transaction, or even as a run-of-the-mill crime: the oldest profession is also the oldest pretext for outraged moralising and unrealistic lawmaking devised by man.

In recent years, governments have tended to bother with prostitution only when it threatened public order. Most countries (including Britain and America) have well-worn laws against touting on street corners, against the more brazen type of brothel and against pimping. This has never been ideal, partly because sellers of sex feel the force of law more strongly than do buyers, and partly because anti-soliciting statutes create perverse incentives. On some occasions, magistrates who have fined streetwalkers have been asked to wait a few days so that the necessary money can be earned.

So there is perennial discussion of reforming prostitution laws. During the 1990s, the talk was all of liberalisation. Now the wind is blowing the other way. In 1999, Sweden criminalised the buying of sex. France then cracked down on soliciting and outlawed commercial sex with vulnerable women—a category that includes pregnant women. Britain began to enforce new laws against kerb-crawling earlier this year, and is now considering more restrictive legislation (see article). Outside a few pragmatic enclaves, attitudes are hardening. Whereas, ten years ago, the discussion was mostly about how to manage prostitution and make it less harmful, the aim now is to find ways to stamp it out.

The puritans have the whip hand not because they can prove that tough laws will make life better for women, but because they have convinced governments that prostitution is intolerable by its very nature. What has tipped the balance is the globalisation of the sex business.

The white slave trade

It is not surprising that many of the rich world's prostitutes are foreigners. Immigrants have a particularly hard time finding jobs that pay well; local language skills are not prized in the sex trade;

prostitutes often prefer to work outside their home town. But the free movement of labour is as controversial in the sex trade as in any other business. Wherever they work, foreign prostitutes are accused of driving down prices, touting “extra” services and consorting with organised criminal pimps who are often foreigners, too. The fact that a very small proportion of women are trafficked—forced into prostitution against their will—has been used to discredit all foreigners in the trade, and by extension (since many sellers of sex are indeed foreign) all prostitutes.

Abolitionists make three arguments. From the right comes the argument that the sex trade is plain wrong, and that, by condoning it, society demeans itself. Liberals (such as this newspaper) who believe that what consenting adults do in private is their own business reject that line.

From the left comes the argument that all prostitutes are victims. Its proponents cite studies that show high rates of sexual abuse and drug taking among employees. To which there are two answers. First, those studies are biased: they tend to be carried out by staff at drop-in centres and by the police, who tend to see the most troubled streetwalkers. Taking their clients as representative of all prostitutes is like assessing the state of marriage by sampling shelters for battered women. Second, the association between prostitution and drug addiction does not mean that one causes the other: drug addicts, like others, may go into prostitution just because it's a good way of making a decent living if you can't think too clearly.

A third, more plausible, argument focuses on the association between prostitution and all sorts of other nastinesses, such as drug addiction, organised crime, trafficking and underage sex. To encourage prostitution, goes the line, is to encourage those other undesirables; to crack down on prostitution is to discourage them.

Brothels with brands

Plausible, but wrong. Criminalisation forces prostitution into the underworld. Legalisation would bring it into the open, where abuses such as trafficking and under-age prostitution can be more easily tackled. Brothels would develop reputations worth protecting. Access to health care would improve—an urgent need, given that so many prostitutes come from diseased parts of the world. Abuses such as child or forced prostitution should be treated as the crimes they are, and not discussed as though they were simply extreme forms of the sex trade, which is how opponents of prostitution and, recently, the governments of Britain and America have described them.

Puritans argue that where laws have been liberalised—in, for instance, the Netherlands, Germany and Australia—the new regimes have not lived up to claims that they would wipe out pimping and sever the links between prostitution and organised crime. Certainly, those links persist; but that's because, thanks to concessions to the opponents of liberalisation, the changes did not go far enough. Prostitutes were made to register, which many understandably didn't want to do. Not surprisingly, illicit brothels continued to thrive.

If those quasi-liberal experiments have not lived up to their proponents' expectations, they have also failed to fulfil their detractors' greatest fears. They do not seem to have led to outbreaks of disease or under-age sex, nor to a proliferation of street prostitution, nor to a wider collapse in local morals.

Which brings us back to that discreet transaction between two people in private. If there's no evidence that it harms others, then the state should let them get on with it. People should be allowed to buy and sell whatever they like, including their own bodies. Prostitution may be a grubby business, but it's not the government's.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Those Olympic Games

A matter of priorities

Sep 2nd 2004
From The Economist print edition

Great sport, great television, pity about the misspent billions

Reuters

WELL, for a fortnight it was a splendid party. Now for the Olympic bills—and that hangover will last for years. The Greek Olympic committee reckons it can break even: half of its $2.3 billion budget for running the games will come, via the International Olympic Committee, from broadcasters, most of the rest from commercial sponsors, ticket sales and merchandising. But what about the taxpayer? Overall, Greek and (modestly) other European Union taxpayers have spent $300m helping to run the games, nearly $1.5 billion keeping them secure, and some $7 billion preparing facilities for them. In all, that means near 5% of 2003 Greek GDP, roughly $800 for every single inhabitant, pensioner or babe, taxpayer or not. Top-level sport is a business, albeit not, in the Olympic version, one aiming for profit—nor answerable to outside shareholders. Should it be subsidised to this extent?

Most Greeks think so. They were told the games would be costly. Few can have doubted the costs would go wildly over budget; in the event, by about 50%. That figure of $800 per head was not put flatly to them, but if the opinion polls are any guide, four Greeks in five welcomed the games—and probably still do: their country rebutted the sneers that nothing would be ready, it ran the show well, it has had a terrific time and weeks of exposure to the world's cameras, and it is left with some durable improvements to its infrastructure. Anyway, these Greeks can say, an elected government, backed by public opinion, is entitled to do what it likes: others send men into space, we run the Olympics—as we should have been allowed to do in 1996, centenary of their first modern celebration.

That is true. But democratic governments can do damn-fool things; sending men into space, for example. Was the Greeks' spending wise? Prestige, publicity and proud memories are not to be ignored. But what else is left? A magnificent stadium and its accompanying public park in Athens, plus various other venues in the city or nearby; four big provincial stadiums; some cheap housing in the capital; better roads there, a bigger and better metro system, a new suburban rail line and a new tramway to the southern beaches. As one Athenian version puts it, 20 years' infrastructure improvements in five.

Actually, that is not what they got. Less than $1.5 billion of the money spent has gone into the EU-subsidised transport improvements, sensible as they may be. Two weeks of security apart, most of the rest has gone into the new sports facilities. Some of these will be useful in the future, some less so. It is a fair bet that all will lose money, unless Greece can somehow achieve what rich and sports-mad Australia, with its inheritance from the Sydney games of 2000, has not. That seems unlikely. Granted, sports facilities can be a public good, and one that most voters approve of. But are world-class sports facilities really the public good on which the hugely indebted government of a small and not very rich country such as Greece should rush to spend over $5.5 billion? What about schools and hospitals, or the

roads and other bits of infrastructure that might generate business investment, and so produce genuine economic growth, rather than mere prestige?

In this context, the Greek government's claim that “oh, we'll cut spending in other ways” is hardly persuasive or even to the point. If public spending ought to be or can readily be cut, cut it anyway. If you need better public infrastructure, invest in what you need, not in what suits the International Olympic Committee.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Brazil and Argentina

To Lula's credit

Sep 2nd 2004
From The Economist print edition

Brazil does better than Argentina, but still needs reform

Reuters

IN 2002, when Luiz Inácio Lula da Silva was elected as Brazil's first left-wing president, he faced a choice. He could opt to honour Brazil's large public debt and check a threatening burst of inflation. Or he could try to evade the debt burden, either by defaulting on part of it or by allowing inflation to erode its real value. Many of his supporters counselled the latter. They argued that Brazil's deep-rooted injustices demanded a switch of public money from debt payments to social programmes.

To their credit, Lula and his finance minister, Antônio Palocci, opted for the rigours of economic orthodoxy, honouring the debt and tightening fiscal and monetary policies. This had a cost. Brazil's economy suffered recession, albeit a brief and mild one. Neighbouring Argentina defaulted on its (even more burdensome) debt in 2001. Its subsequent economic recovery has been swift and strong. Lula's popularity slid, while in Argentina, President Néstor Kirchner basked in popular acclaim.

Now matters look a bit different. Argentina's recovery has started to slow. This week Mr Kirchner told the IMF's new managing director, Rodrigo Rato, of his government's plan to leave Argentina's loan agreement in limbo while it tries to launch a take-it-or-leave-it writedown of some $100 billion in defaulted debt. Even if this bond swap goes smoothly (a big “if”), sustaining recovery will depend on Mr Kirchner's ability to persuade firms that his Argentina is a safe place in which to invest. Given his bullying treatment of some companies, such as privatised utilities, that may be hard.

Lula, by contrast, is starting to reap the fruits of macroeconomic rigour. This week came news that in the second quarter Brazil's economy grew by 5.7% compared with the same period last year—the third successive quarter of strong growth. Inflation remains a worry, but at 7% over the past 12 months, not a huge one. The public debt is a far bigger headache. But the numbers are at least starting to move in the right direction: from a peak of 59% of GDP last December it fell to 56% in June. Unemployment, too, is on the way down, while real wages are rising. So too, is Lula's approval rating.

Just as important, Brazil's growth looks more sustainable than Argentina's. Investment has increased sharply. After a difficult decade, in which Brazil grappled first with ending chronic inflation and then with the fiscal disorder that this had concealed, there is a real chance that South America's spluttering economic motor could start to purr.

A bloated state in need of reform

A cautious case can also be made that a big shift in Brazil's economic culture is under way. The decision to honour the public debt owed much to the fact that most of it is owed to Brazilians, their banks and their pension funds. Lula's government is also trying to persuade Congress to approve a bill to stiffen the bankruptcy law to make it easier for lenders to collect loan guarantees. Brazil may be changing from a debtors' paradise into a creditor-friendly place—a transition all developed countries made at some point in their history.

Nevertheless, three big cautionary notes are worth remembering. Brazil remains vulnerable to sudden shifts in the world economy. A sharp rise in interest rates in the United States could have a knock-on effect, making the debt burden unbearable. Second, Brazil's growth could still be held back by the government's sloth in tackling micro-economic obstacles—poor roads and ports, high taxes and oppressive government regulation. Third, Brazil still faces several years of heavy debt payments. Last year, for example, the federal government spent some 40 billion reais ($13 billion) on debt service—a sum equal to 13% of its revenue and 2.5% of GDP. Even so, it rolled over debt totalling a further 4.2% of GDP.

How can Brazil make this huge fiscal effort while also meeting urgent social needs? The wrong answer is to raise taxes. These already total almost 40% of GDP—a figure close to that of many rich countries. In fact, the state already spends generously on social programmes. But much public money is squandered on vested interests, duplication or inefficiency (see article). Lula can be proud of his economic choice. Now, the challenge is to help the 60m Brazilians who live in poverty by ensuring faster growth and by reforming the state.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Iran

Decision time approaches

Sep 2nd 2004
From The Economist print edition

The hard diplomatic task of denuclearising Iran

AFP

IS IRAN'S theocratic regime much of a threat to anyone other than its own mightily put-upon people? And even if it is, what can the outside world do about it? Twenty-five years after the revolution that brought the ayatollahs to power, their grip is again crushing the breath out of would-be reformers. Critics in the press are locked up. Human rights are trampled. A new conservative-dominated parliament has squelched plans for much-needed economic reforms (see article). With hardliners in the ascendant, hope of turning aside Iran's troubling nuclear ambitions is fading too. Yet a nuclear-armed Iran is a danger worth averting.

Over the past 18 months Iran has reluctantly confessed to breaking every rule in the Nuclear Non-Proliferation Treaty (NPT) rule-book. That is, bar one: it still denies trying to build a bomb. Few believe that. If all it wanted, as it claims, was to use nuclear power to keep the lights on, why lie for 18 years to the International Atomic Energy Agency (IAEA), the UN body that checks that nuclear materials are not diverted for military purposes? Why secretly experiment with plutonium and uranium (both possible bomb ingredients)? Why buy machinery from black-market middlemen—the same ones who supplied Libya with a weapon design as part of its uranium-enrichment starter kit? The IAEA's latest report on Iran this week adds no new charges. Yet the rule-breaking record stands.

Would it matter if Iran did get the bomb? It no longer attempts to export revolution, and it lives in a dangerous neighbourhood, now with American troops also nearby. Although it contributes to those dangers, by refusing to recognise Israel's right even to exist, and by arming groups that reject peace with it, Iran fires off rhetorical salvoes, not missiles. Wouldn't a nuclear-armed Iran be similarly deterred, since any attempt to use its weapons would invite a devastating response?

Bear in mind that cold-war deterrence between America and the Soviet Union barely survived numerous crises and miscalculations. A fissile region that has lived uneasily with Israel's bombs would be unlikely to accept a nuclear-armed Iran with equanimity. Whatever Iran's motives—regional primacy or mere technological one-upmanship—the nuclear chain reaction could quickly see Egypt, Saudi Arabia, Syria and even Turkey follow suit. Unlike India, Pakistan and Israel, which never signed the NPT, Iran's violations would also fatally undermine a treaty that has so far kept regional rivalries below the nuclear threshold in many dangerous places.

It was in hopes of averting all this that last October Britain, France and Germany offered Iran a face-saver: a delay in reporting its nuclear transgressions to the UN Security Council if Iran suspended all

uranium-enrichment-related activity and told all to the IAEA's inspectors. If suspension turned permanent, more trade and technology would flow. But Iran's nuclear story was full of holes. Enrichment-related work never quite ceased, and more is under way again. Yet Iran wants the IAEA off its case.

Beyond shoulder-shrugging, outsiders now have two options: more diplomacy, or force. There are no very good military options—Iran's nuclear installations are scattered, and some may be hidden—but there are some. As Israel likes to point out, its attack on Iraq's Osirak reactor in 1981 put back Saddam Hussein's bomb-building ambitions. It is also worth noting, however, that it did not end them. Yet for diplomacy to nudge Iran on to a safer course, it will need to be a lot more muscular, and better co-ordinated, than hitherto.

Add to the costs, expand the benefits

The Europeans' October gambit has failed. When the IAEA's board meets later this month there is no longer any excuse to delay reporting Iran's rule-breaking to the Security Council. But then what? When North Korea was similarly reported, for breaking the NPT and then flouncing out, Russia and China blocked further action. Russia claims to oppose both treaty-breaking and force; in that case, it needs to lean on Iran a lot harder. America argues, rightly, that without the credible threat of international sanctions (not just its own), hitting trade and investment in oil and gas, the clerics won't budge. Yet if they are to weigh differently the costs of their nuclear option, they also need to know what alternative future to expect.

Iran can still enjoy the benefits of civilian nuclear power, even after giving up its dangerous fuel technologies. Talks on that need to lead on to a wider dialogue—including with reluctant America. Meanwhile an Iran that lives up to its anti-nuclear promises would be a likelier candidate for WTO membership. And as a first step towards a more secure Middle East, free of all weapons of mass destruction, there needs to be serious discussion of regional confidence-building measures. Will Israel-hating Iran buy any of that? Backed by the threat of real sanctions, it is worth a try. If diplomacy is ever to denuclearise Iran, the time to try harder is now.

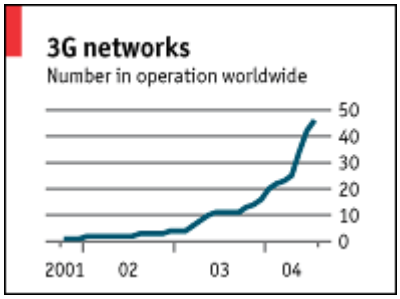
Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Mobile telecoms

The lessons of 3G

Sep 2nd 2004
From The Economist print edition

It was the biggest gamble in business history. Was it a good idea?



FOUR years ago, at the height of the technology bubble, mobile-phone operators around the world, but mainly in Europe, agreed to pay the staggering sum of €109 billion (then $125 billion) for licences to build third-generation (3G) mobile networks. The cost of constructing the networks is expected to be about the same again between 2001 and 2007. Clearly, this vast outlay can be justified only if there is strong demand for 3G services. But as 3G networks are switched on around the world, several years late in many cases, there does not seem to be much enthusiasm for them. These new networks allow operators to offer whizzy new services, from video-telephony to music downloads, but they will not be the money-spinners originally imagined (see article). The $250 billion gamble—the biggest bet ever on a new technology—will not, in other words, pay off for the operators who placed it.

In part, that is because Europe's regulators, having emptied the industry's coffers, then proved insufficiently flexible. As 2G networks filled up, regulators offered the operators no alternative but to bid for new 3G capacity, so in many cases operators were bidding for the right to stay in business. Once the bubble burst, operators were not allowed to resell unwanted licences; nor were they allowed to switch to alternative technologies when the technology they had originally chosen, known as W-CDMA, was delayed for several years by technical problems. But the operators must also share the blame. They became caught up in their own hype. Many operators made the mistake of bidding for 3G licences in foreign countries where they had no established networks, and later chose to give back the licences rather than building a 3G network.

Recognising that they have almost no chance of recouping the money spent on 3G licences, most operators have now written down their value accordingly. The one notable exception is Vodafone, the nearest thing to a genuinely global mobile operator, which may be able to make up for the fact that it overpaid in Britain and Germany by making money from 3G elsewhere. But for most other operators, the licence auctions were a bad dream they would rather not remember.

Surely the 3G fiasco was a great success from the point of view of the regulators, who raised enormous amounts of money? The trouble is that the regulators' main aim was not to raise money, but to entrench Europe's lead in mobile telecoms. A strong dose of industrial policy had worked wonders last time around, with 2G. Regulators and operators had agreed on a single standard, called GSM, which replaced dozens of competing standards and allowed easy roaming from one country to another. As GSM emerged as the dominant global standard, European firms (notably Nokia of Finland and Ericsson of Sweden) prospered. Then, as the internet boomed, it was assumed that a mobile-internet boom would follow. Compelling Europe's operators to switch to 3G, rather than offering them more 2G capacity, would ensure that European firms would be in the vanguard of this new boom.

Success breeds failure

But when the bubble burst and the W-CDMA standard backed by European vendors and operators was delayed, Europe began to fall behind. It did not help that operators were prevented from switching to other technologies that might have enabled them to launch services sooner. Europe's wireless lead has now vanished: Japan and South Korea are far ahead, using different technology.

So signs that European regulators might soon allow more flexibility, albeit belatedly, in the areas of both

licence trading and technology standards, are welcome. A 3G technology called CDMA450, for instance, which is ideal for use in rural areas, may be allowed into some European countries, along with other promising wireless-broadband technologies. With luck, greater flexibility will signify that regulators are stepping back—and that 3G will mark the high-water mark for aggressive regulation. For as wireless technology advances, the trend is towards technologies (such as Wi-Fi and ultrawideband) that require a lighter regulatory touch. To prevent a repeat of the 3G fiasco, there ought henceforth to be less, not more, intervention by Europe's regulators in mobile telecoms.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Letters

Sep 2nd 2004
From The Economist print edition

The Economist, 25 St James's Street, London SW1A 1HG
FAX: 020 7839 2968 E-MAIL: letters@economist.com

Russia's rotten statelets

SIR – I agree that the situation in conflict zones of the former Soviet Union is bad, both in terms of living standards and legality ("A matter of Russian honour", August 21st). But there is a fundamental right of any nation to self-determination. The main question is why Russia refuses to protect its citizens and passport-holders in these places.

I do not think that Russia has transferred its worst features, such as crime, corruption and smuggling, to the regimes it supports. First, those features of the sick Soviet society are common in all former Soviet republics. It takes time to recover from this bad heritage. Second, it is unfair to lay the blame on Russia. The EU and America support the regimes in Moldova and Georgia respectively, although it is clear that the more support the leaders of these countries get, the more aggressive they become towards the unsolved problems.

Alexei Grigoriev
Moscow

SIR – How can you write about Russia's encouragement of secessionist statelets without pointing out the contrast with Chechnya?

Roger Beetham
London

SIR – Having worked both in the separatist Transdniestrian region and in Moldova itself, I disagree with your characterisation that the creation and existence of this enclave is a big reason why Moldova has failed to reach its potential. This certainly does not help but obstacles to growth in Moldova have more to do with a poor infrastructure, arbitrary enforcement of the rule of law, deficient property rights, excessive regulation and corruption than the existence of the enclave.

It is interesting to note that the son of Transdniestria's "president", Igor Smirnov, in addition to heading the customs service, is also said to own a chain of western-style department stores featuring exotic foodstuffs more likely to be found in Toulouse than Tiraspol. A welcome if intermittent source of peanut butter in the region.

Jacob Bowman
Columbus, Ohio

Deutsche Bank

SIR – You give a startling misrepresentation of the transformation of Deutsche Bank ("A giant hedge fund", August 28th). In fact, over the past three years Deutsche Bank has deliberately and dramatically reduced its dependence on risk-taking as a source of operating earnings, while enjoying more substantial progress with clients than at any time in its recent history. According to Fitch, a rating agency, "DB's market risk from its trading operations is below most of its US peers."

The earnings of all the bank's core businesses derive overwhelmingly from transactions in which it acts on behalf of clients. Independent market-data providers, including Thomson and Greenwich Associates,

have consistently ranked Deutsche Bank as the number one bond underwriter in the euro zone, as a leader in international debt and equity markets, and as one of the world's largest foreign-exchange and derivatives houses.

Far from “burning its boats” with its German retail customers, Deutsche Bank has reaffirmed its commitment to being a leading player in those continental European markets in which it has a substantial presence, including Germany, Italy and Spain. In the first half of this year, the bank's private and business-clients division has increased profits by 62% year-on-year and we believe that it can do more. We agree with you that a strong retail base is crucial.

Further strengthening this retail base is a key part of our development strategy. Where there is potential for a deal, it is our responsibility to examine it carefully, as we did with Postbank. Our decision not to pursue that option was well understood and supported by leading equity analysts. Deutsche Bank has a clear growth strategy that is based on developing all of its core businesses. You are not, of course, obliged to approve of that strategy. I do believe that you are required to report on it accurately.

Josef Ackermann
Chief executive
Deutsche Bank
Frankfurt

Nigeria's getting better

SIR – You do your readers a disservice with your article on Nigeria's efforts to reform its economy (“Reforming the nearly unreformable”, August 7th). The truth is that while many challenges remain, reform is working. Good fiscal management has produced a tight fiscal stance centred on assuring a fiscal deficit of no more than 2% of GDP in 2004. The latest report from the IMF is a strong endorsement of what the government of President Olusegun Obasanjo is doing. Deregulation of the oil sector provides unambiguous proof that Nigeria is ready to take painful and even unpopular steps to build a solid foundation for its economy. It is a big and unprecedented achievement.

The deregulation of the telecoms sector, which has produced 5m GSM lines in three years, is another key benefit of reform. So is increased foreign and domestic investment coming from such notable companies as Nestlé, Procter & Gamble, MTN and Nigerian Breweries, not to mention concrete evidence of growing international confidence in Nigeria as shown by the heightened presence of the World Bank, the United Nations Development Programme, Britain's Department for International Development, etc.

The future for the little girl in the rather bleak photograph accompanying your piece (print edition only) is very bright.

Ngozi Okonjo-Iweala
Minister of finance
Abuja

Business opportunities

SIR – Your article on the increase in 419 scams emanating from South Africa needs putting in perspective (“Go south, con man”, August 14th). Our organisation receives on average more than 50 attempted 419 scam letters a week. The great majority of these still come from Nigeria and other west African countries, with a few coming from central Africa. All these 419 letters are, to say the least, very amateurish. The number of 419 letters coming out of South Africa is still minimal in comparison with the amount coming from the rest of Africa and indeed Europe.

The “advance fee” frauds and bogus lottery winnings present a far more sophisticated form of fraud that emanates from both Britain and eastern Europe. Irrespective of where the 419 scam or fraud originates the message must be that if greed overtakes sanity and if it sounds too good to be true, then it probably is and the participant acts at his own peril.

Pat Cunningham
Executive director
South African Fraud Prevention Service
Johannesburg

Trainee torturers

SIR – You talk of journalists behind bars in the pages of George Orwell ("Blaming the messengers", August 21st). There are no journalists behind bars in "1984" because there are no journalists. The only mention of them is in the history of the totalitarian party, which was recruited in part from the ranks of that profession. O'Brien, Winston Smith's torturer, could well have been a journalist before the revolution.

Gareth Penn
Greenbrae, California

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com SPECIAL
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Defiant Iran

The world of the ideologues

Sep 2nd 2004 | TEHRAN
From The Economist print edition

AFP

Seldom has a bargain between Iran and the West seemed so out of reach

IRAN'S continuing progress towards becoming a producer of nuclear fuel was confirmed this week in a report by Mohamed ElBaradei, the head of the International Atomic Energy Agency (IAEA). Unless it abandons that aim, and allays the suspicion that its atomic ambitions are military in intent, Iran may be referred, before the end of this year, to the UN Security Council for violations of the Nuclear Non-Proliferation Treaty. UN sanctions could follow. Forget those high hopes that encouraged the world when reform-minded Muhammad Khatami was elected president in 1997; the Islamic Republic is firmly back in the international doghouse.

Deservedly so, say a growing number of countries, led by the United States and by three members of the European Union: Britain, France and Germany. Two years after an exiled opposition group began revealing the scope of Iran's undeclared programme, the Iranians have continued to try to hide awkward truths, notably those concerning their experiments with the fuel technologies that involve enriching uranium and making plutonium.

The country is inching towards being able to master the nuclear-fuel cycle. During the summer, the Iranians, defying an appeal by Mr ElBaradei, produced experimental amounts of the gaseous uranium that, when fed into centrifuges, can be turned either into low-enriched uranium suitable for civilian reactors, or into high-enriched uranium useful only for bombs. Now they have told the IAEA that they are set to produce much more—enough, if Iran so chooses, to produce high-enriched uranium for several nuclear weapons.

Iran also revoked an earlier undertaking to stop making centrifuge components. And it has so far ignored appeals to suspend work on a heavy-water reactor that is not well suited for producing electricity, but is well suited for producing plutonium.

Such misdeeds apart, this week's report also reprimands Iran for not divulging more about a second, secret centrifuge programme that came to light early this year. The story that Iran had designs for more advanced enrichment machines in 1995 but stuck them in a cupboard for seven years, strikes inspectors as implausible.

But there might be one point, at least, in Iran's favour. Mr ElBaradei confirmed that some traces of high-enriched uranium detected by his inspectors do not constitute yet more evidence of secret uranium enrichment, but rather, as the Iranians have said all along, that equipment bought on the black market was already contaminated. Other such traces are still being investigated, as are low-enriched ones that seem to indicate that Iran has done more experimenting than it has owned up to.

Do what we say, or else

After the report has been discussed by the agency's governing board, America and the European trio are expected to try and muster support from their fellow governors for a resolution that lays out the demands that Iran must meet. Iran may be asked to suspend its feedstock experiments and (once again) to stop making centrifuge components. The governors will urge Iran's parliament to ratify a protocol that provides for intrusive spot inspections of suspected nuclear sites. If Iran fails to meet these demands, they will press for it to be referred to the Security Council.

It is far from certain that the Iranians will accede to these requests. Last October, they bowed to pressure from the European three, undertaking to provide the agency with a complete account of their nuclear history. They suspended uranium enrichment and went on to sign (though not yet to ratify) the protocol. But their account turned out to be full of holes. Further evasions came to light. Yet Iran now angrily demands that the Europeans press for its nuclear programme to be removed from the IAEA's agenda.

In the past year, the country has changed in ways that point not to accommodation, but to recalcitrance. As Mr Khatami sits out a final, dismal year in office (Iranian presidents are allowed two terms only), his hardline opponents and their supporters in the Islamic Revolutionary Guard Corps (IRGC) are gathering untrammelled power. In February's parliamentary elections, conservative candidates benefited from the disqualification of more than 2,000 reformist candidates, and thus won control of the chamber.

The previous, reformist parliament favoured co-operation with the IAEA; its foreign affairs committee supported the October deal. The new chamber is packed with little-known hardliners, many of them drawn from the ranks of the IRGC. Without a strong shove from their patrons in the clerical establishment, they are unlikely to ratify the protocol.

Revolutionary bravado

Ever since Mr Khatami was first elected, his conservative opponents have been itching to reverse his internationalism: his conciliatory policies abroad and his liberalising measures at home. Determined to bolster the country's old revolutionary zeal, conservative ideologues are prepared to promote core revolutionary ideals from behind a wall of isolation. The alternative, as they see it, is to cave in to pressure on the nuclear issue, liberalise the economy, and submit to creeping western values.

That message was discernible in an isolationist speech that Ayatollah Ali Khamenei, the country's supreme leader, delivered in June. Mr Khamenei expressed frustration at what he called the “apeing” of western mores, and castigated the “Zionists” who control the West's “sham” democracy. Alluding to Iran's pursuit of nuclear technology, he attacked those who advocate “going down on our knees” before “the powers of global arrogance”. He predicted that Iranian technology would soon outstrip the West's.

Last month, Mr Khamenei's nationalistic sentiments were given legislative weight when parliament redrafted a liberalising development plan that had been approved by the previous parliament. The amendments, said one deputy, were designed to prevent “foreign dominance of the economy”. Parliament axed those bits of the plan that bound the government to speed up Iran's sluggish privatisation programme and would have let foreigners into the banking and insurance sectors. Among other things, they scrapped foreign energy companies' hard-won right to exploit the oil and gas that they discover. Saeed Leylaz, an economist, calls the amendments “a challenge to the process of liberalisation that started at the beginning of the 1990s. In the past, our route was fixed, and people argued about the best speed to travel along it. Now, no one is sure what route the economy is to take.”

His words could just as well apply to the course of Iran's politics. In Mr Khatami's heyday, reformists were able to use the immense public support that they enjoyed to force small liberalising measures past the unelected conservative institutions that stood against them. Now, the old platforms for reformist ideas—parliament and the press—have been silenced, the former by a rigged election process, and the latter by judicial bans and jail sentences.

Debate has all but died, and the public mood is one of apathy and fatalism. No longer can the EU count on reformist parliamentarians and public figures to echo its calls for Iran to treat its citizens better and behave more responsibly in foreign affairs. Foreigners are bereft of allies.

The demise of the reform movement

Take the instance of some 35 journalists, politicians and intellectuals who languish in jail for uttering contrary opinions. Earlier this year, one of Mr Khatami's ministers was busy negotiating their release with the hardline judiciary. The previous parliament pressed for better jail conditions. But the negotiations have lost momentum. And the new parliament is indifferent to political detainees: the 35 remain behind bars.

The demise of the reform movement means a sharp decrease in Iran's susceptibility to international pressure. In July, the judiciary brazenly cited “lack of evidence” when closing an investigation into the murder of an Iranian-Canadian journalist while she was in detention last summer. On a recent trip to Iran, human-rights delegates from the EU were treated to an aggressive lecture by the official they were talking to.

Searching for further ways to show their new influence, some conservatives favour tightening social restrictions. In the mid-1990s, unmarried couples, and women who broke the Islamic dress code, were terrorised by vigilante patrols and floggings at the hands of the judiciary. After tolerant Mr Khatami was elected, the restrictions lightened. Now some are attempting to reverse this trend. A militia that tries to enforce the old rules is again patrolling the streets of Tehran at night. Rather than a flogging, offenders may be fined and hauled off to “morality classes”.

Amir Mohebian, a well-connected conservative columnist, attributes the new zeal to the desire to make Mr Khatami's final year in office as uncomfortable as possible. After next summer's presidential election, when most people expect the conservatives to manoeuvre one of their own into Mr Khatami's vacant chair, he predicts that “things will calm down”.

Bursting with confidence

It is hard to be sure. The supreme leader may be more pragmatic than his public persona suggests. But he is under pressure from ideologues whose confidence is growing fast. Observing the quagmire in Iraq, they feel less threatened by America than at any time since George Bush included Iran in his 2002 “axis of evil”. A curious bravado pervades Tehran.

Nothing exemplifies this better than the IRGC's closure of Tehran's new international airport in May, in protest at the government's decision to contract foreigners to run it (IRGC warplanes buzzed a commercial airliner that wanted to land, diverting it to Isfahan). The airport remains closed. The IRGC seems wholly indifferent to the price that Iran is paying in international prestige.

The bravado is encouraged by oil. As the second-biggest exporter in OPEC, Iran has benefited hugely from the high oil prices of the past five years, with its GDP growing at about 6% a year. The boom could hardly have been better timed. Every year since 2000, the labour market has had to accommodate some 1m first-time job seekers. The government's response has been to prop up loss-making factories, launch infrastructure projects and dole out cash to private companies that hire workers. In this way, much oil wealth has been frittered away, but the spectre of mass unemployment has receded. People are better off: the newly affluent wear western brand names, invest in property and buy at least $5 billion-worth of smuggled consumer goods every year. But the good times will last only as long as the high oil prices. There is nothing to guard Iran against the calamitous consequences of a sharp drop. There is no Plan B.

In July, the authors of a report sponsored by the New York-based Council on Foreign Relations, a respected think-tank, observed that, “despite considerable political flux and popular dissatisfaction, Iran

is not on the verge of another revolution. Those forces that are committed to preserving Iran's current system remain firmly in control." This prognosis is hard to refute. Depoliticised and cynical, Iranians increasingly question their ability to affect their own destiny. Among young people, a shallow materialism holds sway.

Some choose to ignore the Islamic Republic. Most city-dwellers no longer vote; in Tehran, a mere 34% of voters turned out at February's election. Eschewing dreary state television, they tune in to about 25 illegal satellite channels, most of them broadcast by Iranian exiles in California. But, according to one satellite aficionado, they are no longer interested in the politicised, anti-regime channels: "people now prefer music videos and shows that tell you how to lose weight."

As recently as last summer, televised appeals by Los Angeles-based dissidents brought several thousand Tehranis on to the streets in angry commemoration of an attack that vigilantes launched on reformist students in 1999. This summer, similar appeals were greeted with indifference. All in all, conditions are not conducive to the Iranian meltdown that some Iran-watchers close to the Bush administration, along with the more fanciful sort of Iranian exile, have been predicting.

American policy towards Iran is predicated on the belief that sustained pressure will make the Iranians change their ways—or their regime. As well as its concerns on the nuclear issue, the United States wants Iran to hand over the al-Qaeda operatives in its custody (Iran has offered to do so in exchange for members of the Iranian armed opposition based in Iraq, but this deal was refused). America also wants Iran to restrain Iranian-supported groups—the Lebanese Hizbullah and the Palestinian Islamic Jihad—which violently oppose Israel. And unless Iran publicly disavows its (largely rhetorical) ambition to eliminate the state of Israel, the Bush administration is unlikely to moderate its tough stance towards what it considers a rogue state.

But America's own policy has made it harder to quarantine Iran. The wars in Afghanistan and Iraq—respectively Iran's eastern and western neighbours—have put Iran at the heart of the region that Mr Bush hopes to transform. As a result, the Americans are expecting co-operative behaviour from a regime whose neighbourhood they have occupied, and whose legitimacy they do not accept. Mr Bush rewarded Iran for helping to oust the Taliban from Afghanistan, and for shoehorning its Afghan allies into Hamid Karzai's interim government, by including Iran in his axis of evil.

With increasing explicitness, Iran's resurgent conservatives are contending that Iranian co-operation with America's regional policy depends on a change in American attitudes towards Iran. A few weeks ago, the Iranians quietly suggested that, in exchange for Iran's help in calming Iraq, America should adopt a more lenient attitude towards their nuclear programme. America rejected Iran's attempt to link the two issues—and the Iranians are now making mischief across the border.

Western journalists who have crossed the Iraqi border into Iranian Kurdistan maintain that Iran has given refuge to a group of Sunni militants who are sworn enemies of America and Iyad Allawi's interim government. Others assert that Iran gave important support to Muqtada al-Sadr, the Shia firebrand who challenged the Iraqi government. Clerics close to Ayatollah Khamenei are said to have been on hand during the negotiations between Mr Sadr and Ayatollah Ali al-Sistani, Iraq's pre-eminent cleric, that led to Mr Sadr's withdrawal from Najaf's shrine.

None of this amounts to what Iraq's defence minister has described as an attempt "to kill democracy" in Iraq. In fact, the Iranians have much to gain from the authority that their fellow Shias, by dint of their numerical superiority, expect to gain when the Iraqis go to the polls in January. Moreover, the Iranians expect victory to go to clerics and their protégés, many of whom have close associations with Iran's theocratic regime.

On August 18th, Ali Shamkhani, Iran's defence minister, was asked how his country would react to a putative American attack on its (sole and uncompleted) nuclear reactor. He replied, "We will not sit still. America is not the only one present in the region. We are present from Khost to Kandahar in Afghanistan; we are present in the Persian Gulf; we can be present in Iraq." Being a Shia theocracy in a predominantly Sunni neighbourhood, it is not in Iran's gift to provide stability. But, in the event of military action against it, Iran could become a serious spoiler.

A grand but unlikely bargain

Recent Iranian statements have been bellicose. The conservatives are already treating the EU—which the

reformists used to value as a diplomatic buffer against America—with scant respect. They are willing, as the reformists were not, to capitalise on regional anti-American feeling. Some harbour unrealistic designs of converting China, their second-largest trading partner, into a strategic ally. The old Iranian urge to antagonise friends and provoke enemies is far from dead.

Yet, Iran's more thoughtful conservatives shrink from confrontation, fearing that the Islamic Republic might not be able to survive a reprise of its old global isolation. Although they do not admit it, pragmatic conservatives have long been interested in some sort of grand bargain with the United States. Under this, the Americans would publicly disclaim any intention to destabilise Iran, and would move to end economic sanctions. For their part, the Iranians would offer to help in Iraq and Afghanistan, and (perhaps) abandon their nuclear plans.

But such a deal, never viewed with favour by the Bush administration, is now slipping out of sight. The more his ideological allies stoke anti-Americanism, the harder it will be for Mr Khamenei to forgo revolutionary precepts. In the United States, Democrats too doubt the wisdom of being seen to reward Iran for its brinkmanship. It would take extraordinary imagination—on both sides—to seize on such an unpropitious moment. Meanwhile, the nuclear clock ticks on.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Republican convention

Grinding out a victory

Sep 2nd 2004 | NEW YORK
From The Economist print edition

Getty Images

Why George Bush needs to be careful, rather than daring

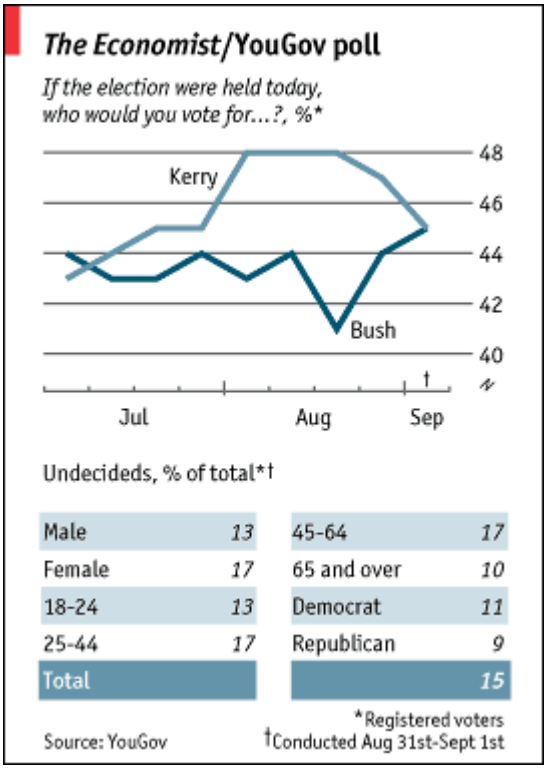
IN JULY, Republicans were facing their convention in New York with some trepidation. It was not the prospect of throngs of protesters that daunted them, nor the problem of finding a Broadway show suitable for their delicate sensibilities (“Naked Boys Singing” was definitely out). Rather, it was George Bush's political position.

The president was falling behind in the horse-race. By large margins, voters thought the country was heading in the wrong direction. The war in Iraq was going badly, the recovery was faltering, Democrats were animated by Bush-hatred, and John Kerry's risk-averse campaign, with its stress on national security, seemed to have established the sort of lead that has rarely been overcome in presidential contests.

Yet as the Republicans arrived, it was Mr Kerry, not Mr Bush, who found himself on the defensive. On the eve of the convention, almost every poll suddenly lurched in the president's favour by half a dozen points. Two weeks ago, our YouGov sample showed Mr Kerry up by seven. Now it shows the race tied (see chart); so do polls for *Time* and the *Washington Post*. The *Los Angeles Times* and Gallup put the president up by three points, and for the first time in months he has pulled decisively in front in state-by-state polling. New polls give him the edge in Florida, Missouri, Ohio, Pennsylvania and Wisconsin—the largest battleground states—and suggest he would get a narrow majority in the electoral college.

This change had nothing to do with the convention and everything to do with the Swift Boat Veterans for Truth, former fellow soldiers of Mr Kerry in Vietnam. Their accusations have left the Democrat in a quagmire similar to the war itself, not because they were true (most were either exaggerated or

unproven), or because Mr Kerry was slow to respond, but because they exposed a fundamental flaw in his campaign. Experience in Vietnam is a poor metaphor for toughness on national security, partly because the wounds of that conflict remain unhealed but more because metaphors are not enough: without substance to back up biography, even unjust attacks can damage a candidacy.



At their convention, Republicans sought to ram home their advantage by linking two favourite themes: the war on terror is the defining feature of the Bush presidency, and Mr Kerry is a flip-flopper. Zell Miller, a nominally Democratic senator, ranted that his colleague has been “more wrong, more weak and more wobbly than any other national figure”. Dick Cheney said the challenger didn't “appear to understand how the world has changed” after September 11th. It is not merely that Mr Kerry gets thing wrong or changes his mind, announced Rudy Giuliani, the former mayor of New York. That might be OK occasionally. In moments of national danger, though, “leadership is the most important [quality]”.

These attacks, however, may not be enough to help Mr Bush win the race. A substantial majority of the population (58%) still thinks the country is heading in the wrong direction, compared with only 38% who say they are satisfied. An election with a sitting president is always a referendum on the incumbent. Mr Bush, not Mr Kerry, will inevitably be the central figure of the campaign. The question for his team is: what else do we do beyond attacking Mr Kerry?

So far the Bush campaign has left Mr Bush's record to speak for itself. That is a bad idea. When you get down to details, much of the record is unpopular. Mr Bush's job ratings hover at, or just below, 50% overall and considerably below that on particular issues. Despite Mr Bush's recent improvement, voters prefer Mr Kerry on health care, education and other domestic matters.

The most daring strategy would be for Mr Bush to lay out an ambitious policy for the second term centred on a fundamental reform of America's entitlement programmes (principally Social Security and Medicare, the federally funded systems that provide, respectively, pensions and health care for the elderly) or basic changes to the tax system. Newt Gingrich, the former speaker of the House (and no stranger to risk), thinks a daringly clear agenda would act as a rallying point for America's centre-right majority and could appeal to a decisive 55% of voters, not just a narrow 51%. It would also accord with Mr Bush's temperament. He sees himself as a “transformational”, history-making president who fearlessly takes on the great challenges of the day.

Mr Bush's acceptance speech (which took place after *The Economist* went to press) seemed likely to take at least a step in that direction, sketching out bits of “the ownership society” Republican policymakers have long promised. This would mean partially privatising Social Security, letting people set up individual retirement accounts and use part of their payroll taxes (which now fund Social Security) to invest in the stockmarket. It would also mean encouraging a switch from employer-provided health care to personal health insurance, by giving tax breaks to those who take out individual health policies.

The trouble is that Mr Bush has precious little room for manoeuvre. The budget deficit—$445 billion this year—enormously complicates Social Security reform, with its estimated $1 trillion transition costs. (And the same incidentally applies to any transformational ideas the president might have in foreign policy: America's armed forces are stretched thin by the Iraq war, limiting the use of military force as an instrument of policy in future.)

These limitations mean that a second-term agenda is less likely to be a starry-eyed attempt to usher in what his chief campaign strategist, Karl Rove, has called “a new Republican majority”, and more a pragmatic effort to keep Mr Bush's options open, were he to win. The campaign is trying to grind out a piecemeal win, based less around one grand gesture than a series of smaller adjustments.

The first priority has been to consolidate the base. In New York conservatives were given sway over the party's platform, which called for changing the constitution to ban gay marriage. That was a backstage necessity. But on stage and prime-time TV Arnold Schwarzenegger, the governor of California, defined

the Republican Party as a big tent and an inclusive one.

Many Republicans feared that in this election, the loathing of Mr Bush would give Democrats an edge in intensity and turnout. But to judge by the convention, loyalty to Mr Bush negates this advantage. During a boring speech by Bill Frist, the leader of the Senate, most delegates chatted among themselves. But every time he mentioned the president, they broke off their conversation with one accord to bellow approval.

In this election, increased partisanship has driven up everyone's negative assessments. Unlike the Democrats, who decided to ignore Mr Kerry's weaknesses (such as his Senate record), the Republicans have tried to tackle Mr Bush's unfavourables head on. For instance, he is seen as stubborn and shallow. So Laura Bush attempted to paint a picture of her husband wrestling with the great issues in the dark reaches of the night. She was one of the few speakers to return to that lost theme of the 2000 election campaign, “compassionate conservatism”, another way of breaking through to the centre.

Mr Bush's greatest vulnerability, of course, is Iraq. The Democrats tried to subsume the war on terror into the Iraq war, arguing Mr Bush was failing in the wider conflict as well as the narrower one. In his speech, John McCain turned that argument on its head. He put the war in Iraq in the context of the war on terror, and justified the first by reference to the second. It is not clear which argument will prevail with voters (now, they distinguish between the two conflicts, saying war against Iraq was not worth the cost but supporting the war on terror by wide margins). But, in a sense, this is not the point. The Arizona senator was saying to wavering Republicans: you may not agree with the president in every particular, but he is right on the great question of the day and deserves your support. This, too, is part of getting to 51%.

So far this year, both candidates have established brief leads, only to find them vanishing as the 50-50 parity reasserted itself. That may occur again now. But for the first time in the race, virtually every indicator—national and state polls, judgments of character and issues—have been moving towards Mr Bush. If he has started to gain ground that he does not lose again, this week could see the start of a winning election strategy.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

New York's protests

What are they fighting for?

Sep 2nd 2004 | NEW YORK
From The Economist print edition

Hundreds of thousands march against George Bush, and everything else

Getty Images

The basic message

"NO MATTER who wins," said one of the protestors outside Madison Square Garden, "I will protest the inauguration." Support for John Kerry was tiny in the massive demonstrations that gathered around the Republican convention in New York. But, more broadly, the protests reflected a sense of grievance that was too large for any candidate, or any party, to capture.

Along with being broadly anti-Bush, groups were anti-war (including Grandmothers Against the War, who met daily outside Saks Fifth Avenue), anti-capitalism, anti-imperialism, anti-gender-discrimination, anti-Fox News (and CNN, and maybe any media), anti-any restraints on protests (except when the point of the protest was to goad police into a reaction and be arrested) and anti-post-arrest detainment conditions, otherwise known as jail.

Many of the protesters were veterans of every big demonstration from Vietnam to Seattle, with pins and banners to show for it. Few of the participants were residents of New York, many of whom fled the city. Of those who stayed, many who supported the causes were still annoyed by the protests themselves.

The protesters prided themselves on their organisation. Months of meetings, negotiations and court decisions had resulted in official permits for designated marches (and even shopping and food discounts for the marchers). Police cleverly minimised the need for arrests by being quick to direct crowds through hastily placed barriers and banning any equipment that looked dangerous.

But as the week progressed, the tenor of the protests changed. Groups began to mass for more spontaneous gatherings, some peaceful, some intentionally packed with civil disobedience. The number of arrests swelled, often with entire groups being taken into custody. Participants sent texts to colleagues, who would appear in swarms. By mid-week, a vast informal network allowed people to flit from event to event.

The new structure became particularly clear on the evening of August 30th, when a small demonstration on Second Avenue on behalf of the world's poor quickly swelled into a near-riot and a police officer was beaten up. A suspect was arrested the next day after appearing at yet another demonstration. As *The Economist* went to press, more than 1,000 people had been arrested. The number of protests, about and against everything, continued to grow.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The electoral week

On the trail

Sep 2nd 2004
From The Economist print edition

Did I say that?

“I don't think we can win it [the war on terror].”

An unscripted moment from Mr Bush. “The Today Show”, NBC, August 30th

Republican inclusivity

“This is New York. Of course we have naked people on Eighth Avenue.”

Michael Bloomberg, New York's mayor, on nude anti-AIDS protesters. Associated Press, August 26th

Endorsement of the week

“If [John Kerry] self-inflicted himself with a grenade, then I'm voting for him! Anybody that stupid has got to be better than the guy we have now.”

Joe Pantoliano, star of the “The Sopranos”, on the furore over Mr Kerry's medals. Washington Post, August 29th

Anyone for Pimms?

“I'm here to protest Bush's horrendous economic principles. After this, I'm going to [play] croquet in Central Park.”

Kathy Merletti, of Billionaires for Bush, who demonstrated in a champagne-coloured gown, lace gloves and parasol. Washington Post, August 30th

That's right, you're not from Texas

“When I'm making my calculations...I'm not doing a focus group in Pakistan, Matt.”

Mr Bush to Matt Lauer on the international implications of his policy decisions. “The Today Show”, NBC, August 30th

Closeted no more

“A few years ago I used this event as an occasion to come out—as a Republican.”

Mayor Bloomberg meets the Log Cabin Republicans. New York Times, August 30th

Small mercies

“This convention may be a bore, but at least it's not the Olympics. Enough already. I cannot see one more damp armpit!”

Overheard by Cindy Adams, New York Post, August 30th

Bring it on

“We, the Yale Cheerleaders for Truth, call upon Yale University President Richard C. Levin to release the Yale Cheerleading Squad archives so that the American people can learn whether Bush's Varsity letter was justly awarded.”

Cheerleaders for Truth want to know if Mr Bush really did cheer for Yale. www.cheerleadersfortruth.com

No time between parachute jumps

“I don't follow this stuff as much as you think I might now. I'm 80, for heaven's sake.”

Former President George Bush on the furore surrounding Mr Kerry's Purple Hearts. National Journal Convention Alert, August 30th

Wrestlers for Bush

“George and I were a little concerned...The entire American wrestling team wanted to date them.”

Laura Bush on her daughters' visit to the Olympics. Associated Press, August 30th

WMD latest

“This is protection and empowerment. I'm part of the pagan cluster, and people all over the world are sending up energy to protest the RNC and Bush.”

Attendee at a Wicca meeting in a cemetery in the East Village. Washington Post, August 30th

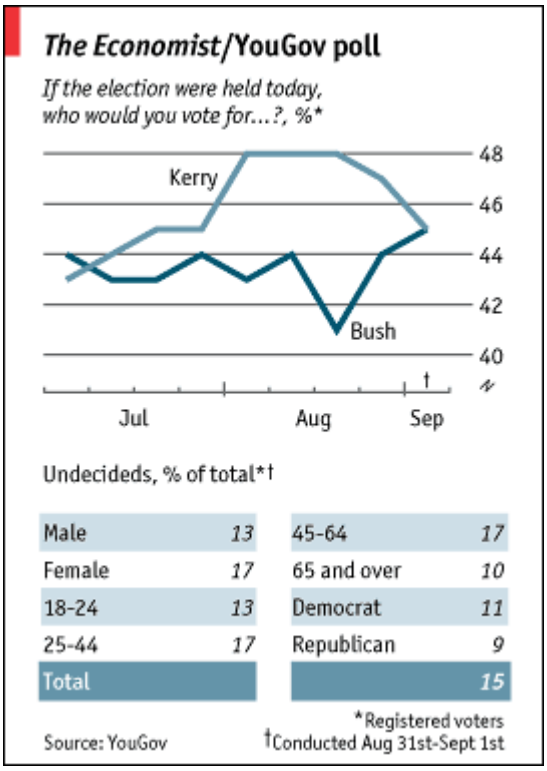
Bush who?

“Giuliani and McCain. Some people refer to them as ‘The ticket’.”

Fred Thompson, former Tennessee senator, at a fund-raising lunch. New York Times, August 31st

Convention product of the week

A badge featuring an elephant mounting a donkey with the motto “Keep Bush on Top”.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Spying for Israel

A mole in the Pentagon

Sep 2nd 2004 | WASHINGTON, DC
From The Economist print edition

Internal squabbles over Iran offer clues to a motive

IT HAS all the makings of a thriller: a spy, powerful lobbyists, a secretly taped rendezvous, a foreign nuclear threat. The unfolding saga surrounding Lawrence Franklin, a veteran Pentagon desk officer, centres on the allegation—he had not been formally charged when *The Economist* went to press—that he gave classified documents on Iran to Israel. But there is growing speculation that the FBI investigation of Mr Franklin is the tip of an iceberg. The reported anger of federal agents at the leaking of the story indicates a bigger probe that may have been under way for at least a year. The agents fear that the trail will disappear in the glare of media scrutiny.

Mr Franklin allegedly passed draft documents on American policy towards Iran to the American Israel Public Affairs Committee (AIPAC), a hugely influential lobbying group in Washington, which in turn allegedly passed them to Israeli officials. Both AIPAC and Israel have denied any wrongdoing. The Israelis maintain that they have been ultra-careful since the huge embarrassment in 1985 when Jonathan Pollard, an American intelligence analyst, was caught spying for Israel. He was later sentenced to life imprisonment.

The news that Mr Franklin had recently been co-operating with federal agents makes it possible that the investigation will snare bigger fish than the clever but eccentric staff analyst (a former Pentagon colleague calls him a “nutty-professor type”). He is an expert on Iran but so far out of Washington's inside circle that he lives with his family (he has an invalid wife and five children) in distant West Virginia.

Unless Mr Franklin was desperate for money or so irritated with American policy that he decided to take matters into his own hands, he may have been doing somebody else's bidding. That leads to the tantalising question: why would Israel, one of America's closest allies, need a spy like Mr Franklin when more senior American officials already tell the Israelis almost anything they want to know?

It could have been useful to Israel, which sees Iran as its most dangerous enemy and is increasingly concerned about its nuclear ambitions, to get information on the deliberations within the Defence Department on American policy towards Iran. Is there a “rogue” operation in the administration waging an internal struggle over this policy? If so, is it possible that Mr Franklin's bosses at the Pentagon sent him to get input from the Israelis and AIPAC to back up their policy position on Iran?

Federal agents have briefed Paul Wolfowitz, the deputy defence secretary, and Douglas Feith, under-secretary for policy. Both men are Mr Franklin's superiors, and belong to the neo-conservative faction, some of whose members have been pushing for “regime change” in Iran. Officials at the State Department and the CIA are much more cautious. While Mr Franklin has been described as generally supportive of the neo-cons' policies, few see him as an ideologue.

The FBI is said to be looking at an unauthorised “back channel” between Mr Feith's office and Iranian dissidents, including an exiled arms-dealer who played a key role in the Iran-contra affair in the 1980s. While it is not clear that the Iranian dissidents are tied to allegations of spying, the arms-dealer, Manucher Ghorbanifar, has also been of interest to the Senate Intelligence Committee.

The leak of Mr Franklin's alleged involvement may have killed any chance of pinning down more senior Pentagon officials. But the scandal is difficult for Israel, which wields considerable influence on American foreign policy, and bad news for George Bush. It is hard to put a positive spin on a spy in the Pentagon, even if he is talking to your friends.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Arab-Americans

Turning away

Sep 2nd 2004 | CHICAGO, ILLINOIS AND DEARBORN, MICHIGAN
From The Economist print edition

A group that voted for Bush last time loses faith in him

HE WAS known as a good neighbour in the Chicago suburb where he lived. He would help carry groceries, and was ready with a smile and a greeting. But on August 30th Sami Khoshaba Latchin was arrested on charges of lying to immigration officials. Although he had lived in America for 11 years, and was a naturalised citizen, federal officials said they had unmasked him as a “sleeper agent” for Iraqi intelligence.

Earlier this month, also in Chicago, charges were filed against three Palestinians for financing Hamas, a militant Palestinian group. Community leaders said the indictments were politically motivated; unsubstantiated charges have been made against local Muslims in the past.

Among Arabs and other Muslims across America, widespread sorrow over the September 11th attacks has been eclipsed by a rising tide of anger at the Bush administration. This change of mood is important, since Arab and Muslim votes could mean the difference between victory and defeat for George Bush. Estimates vary, but at least 3.5m Americans (most of them Christian) have Arab ancestry. In a different count, some 3m Americans identified themselves as Muslim, many of them from non-Arab places, such as Asia, Africa, and America itself.

In 2000 many backed Mr Bush, in part because they shared his views on abortion and gay marriage. Others felt Al Gore did not work hard enough for their votes, or did not like his choice of Joe Lieberman, a Jew, as his running mate. According to a Zogby poll, over 45% of Arab-Americans voted for Mr Bush in 2000, versus 38% for Mr Gore and 13% for Ralph Nader, who is an Arab-American. In the Detroit area, which has the most visible Arab-American community, a University of Michigan study found that two-thirds of them voted Republican in 2000.

They have now swung sharply away. Polling done for the Arab-American Institute (AAI) in four states shows that John Kerry has picked up significant support, particularly among Arab Muslims, although Mr Nader has his backers too and over one-fifth remain undecided. The polls put Mr Kerry solidly ahead of Mr Bush among Arab-Americans in Michigan, Ohio and Pennsylvania.

Hassan Jaber, who works at an Arab community centre in Dearborn, Michigan, sees the biggest shift away from Mr Bush among Arab immigrants who backed him in large numbers four years ago. “I see a complete reversal,” he says. The shift extends beyond Arabs to the broader Muslim community. “I've never seen such a degree of commonality across the Muslim-American spectrum,” says Kareem Irfan, an Indian-American who heads an association of Muslim groups in the Chicago area. “There is a sense of siege.”

What has turned these people against Mr Bush? Certainly foreign policy is important. Among Arab-Americans polled for the Michigan study, only one-third think America has helped bring stability to the Middle East. The Iraqi-Americans surveyed were likeliest to see America as a stabilising influence—an Iraqi woman was one of the speakers at the Republican National Convention this week—but, even so, the survey shows that less than half of all Iraqi-Americans hold this view.

The state of civil liberties in America has also changed political views. Community leaders say many people believe the authorities are simply looking for reasons to arrest an Arab or Muslim. They resented the special registrations and deportations under the Patriot Act. Arrests in New York and other places suggest to them that mosques are being bugged. Now, when community groups gather, they assume there are FBI agents among them. Charitable giving, one of the core tenets of Islam, has fallen off; donors are afraid they will end up on a blacklist. Arab-owned businesses, from petrol stations to liquor

stores, are allegedly being watched.

Arabs and Muslims also encounter suspicion, resentment and violence among their neighbours and co-workers. According to the Council on American Islamic Relations, reports of harassment, violence and discrimination against Muslims increased 70% last year over 2002, and three-fold over 2000.

The beheading of Americans in Iraq this year led to another surge in hate crimes against Arab-Americans. Since September 2001, many Arab-owned newspapers have closed for lack of money after advertisers were threatened. And Arab-Americans are no longer running for local office in the numbers they used to.

Given these worries, it is striking that so many remain politically undecided. Partly, it is a traditionally independent streak. “Partisan identification is not a big thing for this group,” says Ann Chih Lin of the University of Michigan. But many feel that Mr Kerry is courting Jewish voters, who are big political donors, and moving away from Arab-Americans. “I don't see anything more in Kerry than I see in Bush,” says Eide Alawan, a community leader in Dearborn who says he'll vote Republican.

James Zogby, the director of AAI, contends that candidates need not think of Jewish or Arab votes as an either/or proposition. “If you play these politics as zero-sum, you win one group but you lose the other,” he says. “I don't think Kerry will lose the Jewish vote. This is not about George Bush as the soulmate of Ariel Sharon.” In his view, Mr Kerry can solidify support among Arab and Muslim Americans merely by showing compassion and concern for them. And their votes seem ripe for the picking.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Arms control

Don't trust, don't verify

Sep 2nd 2004
From The Economist print edition

The administration changes tack

Get article background

IT WAS Ronald Reagan who first coined the motto “trust, but verify” to guide the decades-long slog by American and Soviet negotiators to cut the size of their respective nuclear arsenals. Each was determined not to allow the other an inch of cheating-room.

The current Bush administration has no patience with that approach. Early on, it torpedoed an inspection protocol for the Biological Weapons Convention. Its arms-cutting treaty with post-Soviet Russia is just a page long, with no new checking mechanism—if Russia wants to waste its money on more nuclear weapons than it needs, so be it. And this week American officials were attempting to persuade 65 sceptical governments at the Conference on Disarmament in Geneva that much delayed negotiations on a Fissile Material Cut-Off Treaty, or “fiss-ban” (ending the production of fissile material for military purposes), should proceed without considering any verification rules.

Why? An 18-month review, say officials close to the exercise, showed that it would cost more money to verify such a treaty than anyone is likely to want to pay, and checks would have to be so intrusive they could compromise national security. But arms-control enthusiasts smell a rat.

Daryl Kimball, of the Arms Control Association, argues that a properly focused treaty could be monitored with confidence. He puts the reversal of past American policy by the Bush team down to three less high-minded motives: their aversion to multilateral agreements; the worries of Israel and Pakistan, two allies that want to keep the option of adding to their stockpiles; and opposition from the navy, which doesn't want inspectors snooping around to make sure that nuclear fuel for powering submarines is not diverted to power warheads.

The navy has long hated the idea of a fiss-ban, says Rose Gottemoeller of the Carnegie Endowment, a think-tank, but under past administrations it was held in check. As in the Nuclear Non-Proliferation Treaty (NPT), it has long been assumed that a fiss-ban would make an exception for naval propulsion, something more navies than America's have been counting on. Yet some governments may well have opposed that. And some verification professionals have long worried that such an exception would make the rest of the treaty hard to monitor.

Naval concerns played a part in the review, but otherwise administration officials deny that their judgment on verifiability was made on anything other than technical grounds. No other country, they argue, has undertaken a similar systematic review. And they point out that the only difference between production of highly-enriched uranium for civilian purposes and for making bombs is one of intent. That is something inspectors cannot be expected to verify—as the current wrangle over Iran's true nuclear ambitions shows. In any case, governments could still agree on transparency and confidence-building measures to show they are keeping their commitment.

Why support the treaty at all? America stopped producing fissile material for weapons 14 years ago. Yet it sees value in turning that into a legally binding commitment for all, including Israel, India and Pakistan, which never signed the NPT and which could now be brought into at least a part of the non-proliferation regime. The five acknowledged nuclear powers promised a fiss-ban at the NPT review in 2000, but it was meant to be an effectively verifiable one. The next review, in May 2005, could prove a bad-tempered affair.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Campaign finance

The rise and rise of 527s

Sep 2nd 2004 | WASHINGTON, DC
From The Economist print edition

A quirk of campaign-finance law allows a deluge of money

“SHADOWY groups”, the Bush White House calls them, with a hint of drama. They are behind a barrage of ads lampooning the president; one has even organised an anti-Bush rock-concert tour. John Kerry was benefiting nicely from these groups, called 527s after the section of the tax code that governs them, until one—Swift Boat Veterans for Truth—attacked his war record.

Mr Bush has now seized on this to try to rein in all 527s. When Mr Kerry asked him to denounce the Swift Boat group, the president craftily replied that he denounces all such groups, and invited Mr Kerry to do the same. Since 527s are overwhelmingly Democrat-leaning, Mr Kerry is unlikely to oblige.

Though not new to elections, 527s are flush with cash this year thanks to a change in the campaign-finance rules. The McCain-Feingold law of 2002 banned unlimited or “soft money” donations to political parties or campaigns, obliging them to rely on “hard money” donations from individuals up to $2,000. Fearing that Republicans would beat them at this game, the Democrats seized on 527s, which are allowed to use soft money for issue advocacy as long as they do not work with campaigns or candidates. Wealthy individuals such as George Soros were quick to donate huge sums. Now Republicans are joining in.

But Mr Bush and Senator John McCain, among others, say these groups are breaking the rules by using soft dollars when their main purpose is to influence a federal election. Mr Bush wants to take the matter to court. Such groups are supposed to register as political committees with the Federal Election Commission (FEC)—but this makes them ineligible for corporate and labour money, as well as for individual donations over $5,000.

Most 527s would qualify easily as political committees. Groups such as America Coming Together do not even try to disguise the fact that they are working to defeat Mr Bush. But they have been able to skirt the law mainly because the FEC has been dozing. The agency has been slow to draw a line between groups that merely push issues and ones that try to influence elections. Groups have also segregated the soft money they use for voter-drives from the hard money they spend on attack ads, making them harder to classify.

As a result, blatantly partisan 527s are able to claim that they are independent of the campaigns. As political committees, these groups would risk tarring their candidate with any wanton attack. But, as it stands, many seem to be doing a candidate's dirty work for him. Both the Bush and Kerry campaigns are accusing the other of working with outside groups. But this is hard to prove. After all, it doesn't take a face-to-face strategy session with the candidate to know how to hurt his opponent.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Lexington

The other president

Sep 2nd 2004
From The Economist print edition

Dick Cheney, backseat driver par excellence

IN MOST presidential re-election campaigns people don't spare a second thought for the vice-presidential candidate. Nobody voted to re-elect Ronald Reagan because he had George Bush senior on the ticket, or Bill Clinton because he had Al Gore. But this year Americans ought to spare more than a second thought for the man who stepped onto the stage in Madison Square Garden on Wednesday night.

Dick Cheney growled out a speech that was reminiscent of General Secretary Andropov on a bad day. The audience loved him anyway. When he spoke of George Bush never seeking “a permission slip to defend the American people”, they burst into chants of “Four more years!”. Nobody expected lofty rhetoric from this particular vice-president. Mr Cheney's talent is not for the theatrics of power, but for the mechanics.

He is not only the most powerful vice-president in American history. He is also the most controversial, a man whose decisions have repeatedly given even loyal Republicans pause. Four more years of George W. means four more years of Bush-Cheney: the closest thing to a co-presidency America has ever seen.

For the past four years the two men have been inseparable. Most vice-presidents have to fight for time with their boss; Mr Cheney sees his several times a day. Most vice-presidents spend their days at state funerals; Mr Cheney, more than anyone else, picked the members of the current administration. Thereafter he helped to shape the administration's policies on everything from energy policy to the invasion of Iraq.

The Republicans have repeatedly reminded Americans this week that September 11th 2001 defined this administration. But who was in charge on that terrible day? It was Mr Cheney who took most of the key decisions—from hiding the president to authorising the shooting-down of suspicious aircraft—while Mr Bush was holed up in Nebraska.

September 11th was a break from Mr Cheney's normal low-key style. In general, he prefers to direct from behind rather than seize the wheel. From the first, he exploited his boss's penchant for focusing on the big picture in order to control the details. He packed the second tier of the administration with allies such as Paul Wolfowitz, Bill Luti and Stephen Hadley. And he created an axis of influence with Donald Rumsfeld, the man who had given him his first break in national politics, and who shares his no-nonsense view of the world.

Mr Cheney's acceptance speech at last put paid to lively rumours that Mr Bush was planning to dump him from the ticket in favour of somebody who appeals more to swing voters: John McCain, for example. Mr Cheney is clearly a drag on the ticket in purely electoral terms: the latest CNN/Gallup poll finds as many Americans disliking him as liking him. But the rumours, in the end, were hot air. Mr Cheney is so integral to the administration that to dump him would be the equivalent of decapitating it.

The vice-president's unique position raises a serious practical question: what happens if he has another serious heart attack? (He has already had four.) It also raises a serious political question: how well has Mr Cheney used the power he has amassed with such Machiavellian cunning?

In 2000 he was widely seen as the conservative movement's answer to Washington's legendary wise men, such as Dean Acheson and George Kennan. Nobody who studied Mr Cheney's biography, from his hard-right voting record in Congress to his patronage of conservative intellectuals (the famous Laffer curve was first sketched on his napkin), could doubt his ideological bent. But he was one of the most experienced politicians in Washington: the youngest White House chief of staff ever, a congressman for Wyoming and defence secretary. He was careful to wrap his conservatism in the mantle of common sense. Who better to restrain Mr Bush's more gung-ho Texan instincts?

Mr Cheney also brought to his job a sharp sense of how dangerous the world is. Thomas Hobbes used to remark that “fear and I were born twins”. The same can be said of Mr Cheney. As a congressman, he boasted that he never met a weapons system he didn't vote for; as defence secretary, he fiercely resisted pressure for a post-cold-war peace dividend. He tried instead to focus America's armed forces on “new sources of instability” such as terrorism and renegade regimes. This combination of a mastery of Washington bureaucracy and a Hobbesian view of the world should have been perfect for the post-September 11th world.

Ideology's dangers

But few people would now argue that Mr Cheney has lived up to his promise as a wise man. The biggest mistakes of this administration, from the blithe acceptance of soaring deficits to the insistence that Saddam Hussein possessed weapons of mass destruction, have Mr Cheney's fingerprints all over them. He resisted attempts to get both congressional and UN approval for the invasion of Iraq. He has repeatedly favoured secrecy and “executive privilege” over consultation and compromise.

Mr Cheney scored a few points in the administration's defence on Wednesday. He pointed out that the tax cuts had helped to reignite an economy that was sinking into recession. He argued that there was “a difference between leading a coalition of the many and submitting to the objections of a few”. But there are no excuses for swallowing Ahmed Chalabi's “intelligence” hook, line and sinker, nor for trampling over Congress.

The cumulative effect of all these mistakes not only suggests a worrying preference for ideology over common sense, but an arrogant indifference to the checks and balances that are the glory of the American constitution. During the Ford administration, the Secret Service gave Mr Cheney the codename “Backseat”. One of the big questions facing America is whether this particular backseat driver is taking his boss in the right direction.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Public spending in Brazil

Bloated, wasteful, rigid and unfair

Sep 2nd 2004 | SÃO PAULO
From The Economist print edition

An overdue debate begins on reforming Brazil's state

BRAZILIANS stagger under a tax burden which at nearly 40% of GDP dwarfs that of most middle-income countries and is almost high enough to finance a European-style welfare state. Yet all this government spending yields little welfare. Social and economic inequality is greater in Brazil than in any other big country. Brazilian schoolchildren fare worse on standardised tests than their peers in other countries with similar levels of income.

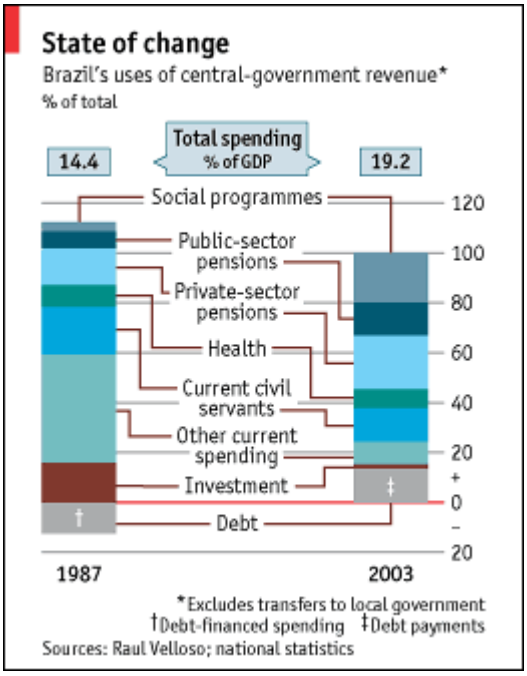
Grumbling about taxes has become audible—and is starting to have an effect. In July, the centre-left government of President Luiz Inácio Lula da Silva backed away from a plan to fill a hole in the publicly financed pension system by raising payroll taxes. *Veja*, the country's leading news magazine, hailed this as a Magna Carta for Brazilian taxpayers. But taxes cannot fall much unless spending falls, too. In Brazil, that is even harder to bring about than in most countries. Only now are Brazilians starting to cast a critical eye on a state that Sérgio Abranches, a political scientist, has called an “anaemic leviathan”.

Some of the critics want to pare the state back to its essentials—an idea most of Lula's ministers reject as “the neo-liberal concept of a minimal state”. The government pays plenty of lip service to improving the “quality” of public spending, but that can mean anything from shrinking the bureaucracy (why do lifts in public buildings have attendants to push the buttons?) to moving procurement on-line. The penny-pinching finance ministry wants to refocus social spending on the poor; ministers who run those programmes clamour for more money. The left blames everything on gargantuan debt payments.

To make matters worse, the national government has little discretion over spending. The lion's share of federal-government revenues are earmarked for debt service, salaries and pensions, and essentials such as health and education. The government passes on around half its revenue from most taxes to states and municipalities, which are similarly restricted. Many of these expenses have been mounting. The federal government has coped by raising taxes—these have risen by more than a third since 1988 and by 11 percentage points of GDP between 1993 and 2003—and by squeezing investment and such luxuries as road maintenance (see chart).

Behind the earmarked spending lie worthy aims: restoring Brazil's creditworthiness, promoting equality and fostering federalism. In practice, the latter two are not well served.

Brazil spends an impressive 15% of GDP on social programmes. Some of this finances a real safety net for the poor, but much of it bypasses them. Pensions for civil servants—a system that ran a deficit of 2% of GDP at the federal level alone last year, benefiting just 1m retired bureaucrats—are the most glaring example. Federal spending on education is in part a rich man's subsidy: most goes to free public universities and nearly half of that benefits the richest 10%. Even unemployment insurance underwrites only the lucky half of workers who have a formal job. Brazil has few programmes that are both targeted specifically at the poor and reach a lot of them. “The distribution of transfers imitates that of incomes before government intervention, reproducing existing inequalities,” concluded a report by the finance ministry last year.



Fostering inefficiency

The “truncated federalism” introduced by the 1988 constitution accounts for much of the leviathan's girth, believes Eduardo Giannetti of Ibmec, a private university. States and municipalities were ceded more control over health and education, along with a chunk of federal tax revenues to pay for them. But the division of labour is fuzzy. Municipalities, in particular, have little power to tax residents—and so have little reason to curb spending. Their revenues more than doubled in real terms between 1988 and 2001—partly because their number rose from 4,200 to 5,560; state government revenues jumped by half.

The system does not foster efficiency. In Minas Gerais, a large central state, public employees are paid on average twice as much as people doing similar jobs in the private sector, says the planning secretary, Antônio Anastasia. A city councilman in Rio de Janeiro state costs 306,000 *reais* ($100,000) on average. The Brazilian Institute of Tax Planning calculates that a third of public funds are stolen or wasted.

“All attempts to solve [overspending] with a dramatic thrust will fail,” says Antônio Delfim Netto, a pro-government congressman who rails against the “scandal” of an overgrown state. But there has been progress. Pension reform began under Fernando Henrique Cardoso, Brazil's president from 1995 to 2002. Lula defied public-sector workers to push through a further trimming of their pensions. Last month, this was upheld by the supreme court. Its short-term effect is modest: by 2010 the deficit in the system will be 4.3% of GDP rather than 5%, according to the World Bank. But it is a start. Meanwhile, emergency income transfers to the poor are being consolidated and expanded.

José Dirceu, Lula's top aide, has proposed the radical idea of delinking pensions from increases in the minimum wage, which would help curb the growth of mandatory spending. The government is bubbling with ideas to improve evaluation and efficiency. The planning minister, Guido Mantega, touts a shift in procurement from bureaucrats to the internet, which could cut costs by 30%. The three armed forces are being told that they can buy more weapons if they buy together.

Good housekeeping is part of the draft budget for next year, released on August 31st. This projects higher public investment with almost no rise in the tax burden. The main reason for this happy combination is higher economic growth, which will ease the pressure for reform.

The federal government lacks the zealotry of states like Minas Gerais, whose desperate financial plight demands what Mr Anastasia calls “a new way of working by the public sector”. Facing a deficit of $780m and a wage bill that consumed three-quarters of revenues, the government that took office last year administered a “management shock”. The state's 21 secretariats (in effect, ministries) were cut to 15. Partly by replacing automatic wage rises with bonus schemes, the wage bill has fallen to 61% of revenues and the deficit has shrunk to $100m. Unlike the federal government, Minas has no inhibitions about outsourcing: it plans to buy 500 new police cars and outsource their maintenance. Part of its reward is a $170m World Bank loan, which will pay—among other things—for paved roads in 85% of municipalities which lack them. Aécio Neves, Minas Gerais's governor, is widely tipped as a future president.

Lula is neither as desperate nor as willing as Mr Neves to reinvent the public sector. “Under Lula, nothing has changed,” laments Raul Velloso, a public-finance specialist in Brasília. He says that spending should rise at a lower rate than nominal GDP. In real terms, spending would continue to grow, but at least the leviathan would start to be cut down to size.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

By invitation

What really happened in Venezuela?

Sep 2nd 2004
From The Economist print edition

A senior election observer, Jennifer McCoy, gives an insider's account of last month's controversial referendum on Hugo Chávez

Get article background

OPPONENTS of President Hugo Chávez have claimed that fraud thwarted their recent attempt to remove him from office in a recall referendum. Venezuela's election agency declared that Mr Chávez won the referendum by 59% to 41%. How can we assess these competing claims?

The opposition's suspicions are based on three things. First, an exit poll supervised by Penn, Schoen, and Berland Associates (PSB), an American polling firm, and conducted by volunteers from Súmate, an opposition civic group, showed the opposition winning by 18 points. Second, there was a pattern of polling stations where several electronic voting machines returned an identical result, in what looked like a pre-programmed “cap” on the number of opposition votes. Third, in some places the “Yes” votes to recall the president were fewer than the number of signatures on a recall petition last year.

I was there directing the Carter Center's election-monitoring efforts. I was concerned when I heard from both sides during the vote that their exit polls each showed them winning by 18 points. In my experience, competing exit polls are normal. But I was concerned about the size of the discrepancy (36 points), knowing that both sides in this deeply polarised country expected to win. Many in Venezuela and in the United States have called into question the referendum's result, as well as the ability of international monitors from the Organisation of American States (OAS) and the Carter Center to detect fraud. Others have raised the spectre of electronic fraud in the American presidential election, citing the Venezuelan experience with new touch-screen voting machines.

Prior to the vote, Venezuela's National Election Council (CNE) threatened to limit the number of observers, and access to voting sites and some technical aspects of the vote. This generated suspicion among Venezuelans. The Carter Center urged the CNE to lift these restrictions, which it largely did. In the end, we received authorisation for all of the observers we requested, access to many of the technical components we asked for, and freedom of movement on election day. Both the OAS and the Carter Center had been mediating in Venezuela for two years and had already observed the signature collection and verification process. We observed all of the prior simulations conducted on the new electronic voting machines.

We planned three tests of the new electronic voting system. First, with the OAS, we conducted a “quick count” in which our observers at a random sample of polling stations (*mesas*) called results in to mission headquarters. This was to check the official results that were transmitted from the machines to CNE headquarters. Second, we drew a larger sample of poll results from those received electronically at CNE headquarters, to test the accuracy of tabulation by the CNE's computers. These tests confirmed there was no manipulation of the software or data transmission.

Missing from those tests was what happened within the black box of the voting machines. Fortunately, the Venezuelan machines were programmed to produce a paper trail: after each vote, a paper ballot was printed, inspected by the voter, and deposited in a cardboard ballot box. We had urged a “hot audit”, an immediate count of the paper ballots. At the last minute, the CNE approved an audit of 1% of the voting machines. But this was only half completed, because of the high turnout, late closing of the polls (some as late as 3am) and poor instructions to CNE auditors. We were only able to observe a few of these “hot audits”, as we needed to be at other *mesas* for our own quick count.

We therefore proposed to the CNE a second audit, three days after the vote, to check the paper slips. We

agreed a methodology with the opposition's technical advisors, but its political leaders decided not to participate (they had wanted to negotiate directly with the CNE). We tested and verified the CNE's computer programme to draw a new random sample of 150 *mesas*, comprising 334 voting machines, and observed the drawing of the sample. We put observers in the main military garrisons where the boxes of paper receipts were stored, *before* the sample was drawn, to avoid any tampering with the chosen boxes. The observers accompanied the boxes to Caracas, and then watched over a meticulous count in which each slip was compared with the electronic result.

The only way the boxes could have been altered would be for the military—historically the custodians of election material in Venezuela—to have reprogrammed 19,200 voting machines to print out new paper receipts with the proper date, time and serial code and in the proper number of Yes and No votes to match the electronic result, and to have reinserted these into the proper ballot boxes. All of this in garrisons spread across 22 states, between Monday and Wednesday, with nobody revealing the fraud. We considered this to be supremely implausible.

This second audit showed that the machines were very accurate. We found a variation of only 0.1% between the paper receipts and the electronic results. This could be explained by voters putting the slips in the wrong ballot box. An additional piece of corroborating evidence was the result from the 15% of polling stations that used the old-fashioned manual ballot. These stations (in mostly rural areas without telephones) were even more favourable to the president, voting 70:30 against recall.

If the machines were accurate, how do we explain the three suspicious factors noted by the opposition? First, the mysterious “tied” results or “caps” on the machines. We found that 402 of 8,100 *mesas* (each with one to three machines) had two or three machines with the same result for the Yes vote; and 311 *mesas* had the same results for the No vote. So the phenomenon affected both sides. We consulted Jonathan Taylor, a statistician from Stanford University. Using various mathematical models, he predicted that 379 *mesas* would have ties (of two or three machines) in the Yes votes, and 336 *mesas* would have ties in the No votes. The error range would be plus or minus 36 *mesas*. So the actual results fell within the range of probability, and do not provide evidence of fraud.

The second oddity was the opposition's exit poll. In countries as polarised as Venezuela, exit polls are risky. They require those conducting them to avoid bias in choosing whom to query, to avoid socio-economic bias in their dress and speech, and to work in a wide variety of neighbourhoods. They also require voters to tell the truth—despite intimidation and strong peer pressure on both sides. Any of these elements could have been lacking.

Puzzles and explanations

The third puzzle was places with fewer Yes voters than signers of the recall petition. Anecdotal evidence suggests that some people who were expected to vote Yes in fact voted No. Overall, more people (almost 4m) voted to recall the president than signed the petition last November (3.4m). But some of the signers might have supported a recall as a democratic right, while themselves not wanting to remove the president. Some may have changed their minds since November. And some may have decided that *Chavismo* in government was more likely to preserve the peace than *Chavismo* in opposition.

Two other factors help to explain the result. First, reputable polls showed Mr Chávez climbing in the months before the vote; three weeks before, he had a nine-point lead among likely voters. Opposition leaders and pollsters told me before-hand that a high turn-out was expected to favour Mr Chávez. The turn-out was a high 70%, compared with an average in previous elections of 55%.

The second factor (which helps to explain the first) was that delays in the collection and verification of signatures gave time for the economy to recover from the previous year's devastating strike. Mr Chávez campaigned tirelessly and spent large sums from record oil revenues on social programmes for the poor. The government also naturalised long-waiting immigrants and registered up to 2m new voters. In contrast, the opposition ran a lacklustre campaign, did not present a clear alternative leader, and could not compete with the government's resources.

In conclusion, the vote itself was secret and free, but the CNE's lack of openness, last-minute changes and internal divisions harmed public confidence in that vital institution both before and after the vote. Divisive rhetoric and intimidating tactics from *Chavistas*, and the opposition's still-unsubstantiated claims of fraud, have exacerbated Venezuelans' cynicism toward elections. It will take a huge effort by both sides to restore trust in this fundamental democratic right before next month's election for governors and

mayors.

Jennifer McCoy directed the Carter Center's observer mission in Venezuela and is a Latin America expert at Georgia State University in Atlanta.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Politics in Mexico

Campaigning as a blood sport

Sep 2nd 2004 | MEXICO CITY
From The Economist print edition

Ganging up on the presidential frontrunner

THE presidential election is not until July 2006, but this week marked the unmistakable start of the campaign. Trumping President Vicente Fox's annual state-of-the-nation speech on September 1st, three days earlier Andrés Manuel López Obrador, the leftish mayor of Mexico City, drew hundreds of thousands of supporters to a rally, where he set out a 20-point plan for a presidential term. Not only does the mayor top the polls of presidential hopefuls (with 31%). He is also cleverly using a threat of legal action—aimed at excluding him from the race—to focus attention on himself.

Congress, at the government's urging, must decide whether to strip Mr López Obrador of the immunity he enjoys as an elected official so that he can face criminal charges that his administration ignored a court order to stop public works on a plot of private land. If he loses his immunity and were then to be convicted, he would be ineligible to stand for president. The wrangling in Congress, whose new session began this week, could drag on into next year.

This will probably scupper any lingering hope Mr Fox might have of getting approval for economic reforms. It also threatens to inject a dose of poison into Mexican politics. It is not only the mayor's supporters who wonder why the government is determined to pursue what—by Mexican standards—is a pretty trivial charge. State governors from other parties have got away with far worse, from drug-running to embezzlement. Mr López Obrador's spokesman dismisses the charges as “politically motivated”. The mayor has distributed 2.2m copies of a comic-strip book portraying him as battling against “dark forces”.

The mayor's party has also jumped on a recent ruling by the electoral body that Santiago Creel, Mr Fox's interior minister and himself a presidential hopeful, overspent during his losing campaign for mayor against Mr López Obrador in 2000. Mr Creel, too, may now face attempts to bar him from the presidential campaign. As Mexican politics becomes a blood sport, Mr Fox looks more and more like a mere spectator.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Malaysia

The freeing of Anwar

Sep 2nd 2004
From The Economist print edition

EPA

Malaysian politics will enter a turbulent new phase with the release of its most charismatic politician

AFTER almost six years in jail, five appeals, two bitterly contested elections and one black eye, Anwar Ibrahim, Malaysia's most famous political prisoner, is free. On September 2nd, the Federal Court, the country's highest, overturned his conviction for sodomy, a crime in Malaysia. Websites were overloaded, mobile circuits jammed and Mr Anwar himself stayed behind to talk to the thronging press for several hours after the verdict. The ruling came exactly six years after Mahathir Mohammad, the prime minister of the day, fired Mr Anwar as his deputy and finance minister. The man all Malaysians once viewed as their future leader finally has a future again—although Malaysia's political system remains stacked against him.

In one sense, the ruling should not come as a surprise. The case against Mr Anwar was hopelessly flawed. His driver, the alleged victim, could not make up his mind about when the purported sodomy occurred. At one stage, he claimed that it had taken place in a building that had not even been constructed at the time. The lower courts did not allow Mr Anwar to present an alibi, or to pursue his contention that the charges were trumped up as a means to keep him out of politics and prevent him challenging Dr Mahathir.

Many Malaysians believed Mr Anwar's claims, and came to see him as something of a martyr—especially when the then police chief beat him up after his arrest, leaving him with a much-photographed black eye. Many also agreed with his assertion that Dr Mahathir was protecting his cronies and exacerbating Malaysia's economic woes following the Asian crash of 1997. The whole saga greatly contributed to the governing coalition's terrible showing in elections in 1999.

But as Malaysia's economy recovered, and especially after Dr Mahathir retired last October, the issue faded. Abdullah Badawi, the new prime minister, led the ruling United Malays National Organisation (UMNO) to a thumping election victory earlier this year, thanks in part to his promises to institute many of the reforms that Mr Anwar had been calling for from his jail cell. Keadilan, the party founded to protest against Mr Anwar's treatment and push his reformist agenda, retained only one seat: that of Mr Anwar's wife, in his home state of Penang. If anything, Mr Anwar's release will increase Mr Badawi's popularity yet more, as the same Malaysians who blamed Dr Mahathir for his persecution attribute his freedom to

some behind-the-scenes signal from the new prime minister.

The dejected opposition, meanwhile, hopes that Mr Anwar's release will give it a new lease on life. But it is far more divided now than it was at the time of his sacking, when he helped to forge a united front against the ruling coalition. The two biggest opposition parties, the secular (and mainly Chinese) Democratic Action Party (DAP), and the Pan-Malaysia Islamic Party, or PAS, have fallen out over PAS's proposal to turn Malaysia into an Islamic state. The DAP is in the middle of a change of leadership, while PAS's followers are at war over the party's miserable showing in the recent elections.

Mr Anwar himself is suffering from a debilitating back injury. He came to court in a wheelchair, under heavy sedation. His doctors did not want him to go at all; they forced him to sign a waiver, absolving them of any responsibility. He plans to fly as soon as possible to Germany for treatment. Sankara Nair, one of his lawyers, says he might be back within a month, in full health—but only on the most optimistic prognosis.

What is more, Malaysian law says that convicted criminals cannot hold any public office for five years after their release. Since Mr Anwar was also convicted of corruption, and only completed that sentence last April, he will not be able to return to parliament, or take formal leadership of any party, until April 2008. Mr Nair insists that Mr Anwar will continue to contest his corruption conviction. Indeed, the Federal Court has scheduled a hearing on his latest appeal for September 6th. But it has already upheld that conviction once; Mr Anwar is now asking the court to reverse its own ruling, something it has never done before. Yet, since the corruption charge related to an alleged attempt to pervert the course of justice in the sodomy case, it is not impossible.

Anyway, opposition politicians do not get many opportunities to promote themselves in Malaysia's tightly circumscribed political system. The law prohibits public rallies without a police permit, and opposition parties, funnily enough, never seem to get hold of one. The police even raided one of Keadilan's private meetings earlier this year. The mass media loyally follow the government line. Neither Malaysiakini, an independent website, nor Haraka, an opposition periodical, have managed to obtain a licence to publish a daily newspaper. Meanwhile, the Internal Security Act, a repressive colonial holdover, allows the government to detain suspects without trial. Mr Badawi, as home minister, locked up several Keadilan activists under the act, and has been holding the son of Nik Aziz Nik Mat, the leader of PAS, for three years.

On the other hand, Mr Badawi will not want to risk his popularity by launching another crackdown on the opposition in the style of Dr Mahathir. Besides, most Malaysians consider Mr Anwar the most charismatic politician of his generation. Mr Badawi, who does not command a personal faction within the scheming ranks of UMNO, might decide that he would prefer to have Mr Anwar on his side: many people suspect a deal has been struck, though this is hotly denied on both sides. The same vexing question that haunted Dr Mahathir—what to do with Mr Anwar—should dominate Malaysian politics for a few more years yet.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

India's opposition

Flagging enthusiasm

Sep 2nd 2004 | DELHI
From The Economist print edition

The Bharatiya Janata Party is an opposition in search of a cause

Reuters

The RSS remains, with flag and shorts

Get article background

THE jailing of a senior leader; an insult to an ideological icon; a purge of its influence in school textbooks and the administration: India's main opposition, the Bharatiya Janata Party (BJP), is presenting itself as the victim of awful persecution. It is not. Rather, it is trying to regain support after its surprise defeat in the general election of April and May. One tactic is to revive enthusiasm for the Hindu-nationalist issues—an ideology known as *hindutva*—that propelled it to national power in the 1990s, but in many places led to communal strife with the Muslim minority.

A prominent figure in the BJP's rise was Uma Bharti, a jailed "martyr". A *sanyasin*, a kind of lay nun, with a gift for rabble-rousing, she was in 2003 elected the BJP's chief minister of Madhya Pradesh, a large central state. Last month she resigned, after the government of the neighbouring state of Karnataka resuscitated a ten-year-old criminal case against her. It covered her involvement in a riot in which six Hindu activists were shot dead trying to defy a ban by planting a flag at a disputed site.

Karnataka's government, like that at the centre, is a coalition led by the Congress party. In reopening the case against Miss Bharti it may have sought revenge on the BJP for its campaign against "tainted" ministers in Delhi—those facing criminal charges. If so, it was a crass mistake. Miss Bharti had been a lousy chief minister. But, having given herself up and gone to prison, she makes a rather good martyr, especially in a case presented as one of patriotic devotion to the flag. Perhaps realising this, the government was this week poised to drop charges against her so that the court could set her free.

That would allow her to help in the campaign for state elections to be held next month in Maharashtra, India's second-biggest state. The BJP is in opposition there, in alliance with Shiv Sena, a party of rabid Hindu nationalists. They have been trying to capitalise on another issue handed them by Congress, involving a controversial local hero, Vinayak Damodar Savarkar. Jailed by the British raj, Savarkar is remembered both as a freedom fighter and as the founding father of Hindu nationalism, one of whose disciples in 1948 assassinated Mahatma Gandhi.

Last month, a Congress minister, Mani Shankar Aiyer, ruled that a quotation from him should be

expunged from a memorial at the prison in the Andaman islands where he was detained. This “insult” to Savarkar has prompted a vitriolic campaign for an apology.

The BJP's parent, a mass organisation called the Rashtriya Swayamsevak Sangh (RSS), or Association of National Volunteers, has another senior Congress figure in its sights: Arjun Singh, the minister of human-resource development. It has threatened to sue Mr Singh for defamation for allegedly accusing the RSS of involvement in Gandhi's murder.

For his part, Mr Singh has been the most outspoken of Congress leaders in attacking the RSS and its ideology. His BJP predecessor oversaw a rewriting of school text-books to present a view of India's history more in line with Hindu-nationalist orthodoxy. Mr Singh has now promised a countervailing “detoxification” of the school curriculum. He has also called for a “cleansing” of RSS elements in the administration.

RSS volunteers' penchant for early-morning gymnastics in khaki shorts is one reason why there is disagreement over whether they are harmless enthusiasts or dangerous fanatics with fascist tendencies. Congress seems divided over whether to confront the organisation and its ideology, or ignore them. With an election campaign to fight, party leaders in Maharashtra mainly seem to wish that Mr Singh and Mr Aiyer would keep quiet.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Japan and Russia

North or south?

Sep 2nd 2004 | TOKYO
From The Economist print edition

Japan's prime minister stokes a territorial spat with Russia

Get article background

TERRITORY is grand, but Japan craves energy far more than land. That is why Junichiro Koizumi, who on September 2nd sailed past some disputed Russian-held islands without landing on them, seems unlikely to get too tough over Japan's territorial claim. The islands—which Japan refers to as the Northern Territories, and Russia calls the Southern Kuriles—lie just north of Hokkaido, and were part of Japan until the Soviet Union seized them at the end of the second world war. The disputed claim prevented the two sides from signing a formal peace treaty after the war, and remains an emotive issue.

Mr Koizumi, who "inspected" the islands from a Japanese coast-guard ship, picked an interesting time to highlight the dispute. His Russian counterpart, Vladimir Putin, will visit Japan early next year. More important, perhaps, Mr Koizumi's party took a beating in upper-house elections in July, and he needs a way to boost his image. Since he took office in 2001, foreign-policy ventures have given Mr Koizumi some of his biggest bounces in the polls: especially a pair of trips to North Korea, in 2002 and earlier this year.

The North Korea issue is losing some of its punch, however. Mr Koizumi has already won the release of all known living Japanese hostages who were abducted by North Korea during the cold war, and their families. In Iraq, where Japanese troops are doing humanitarian work, the best that Mr Koizumi can do now is hope that nothing goes wrong. Unsurprisingly, the populist prime minister has some new ideas up his sleeve. Later this month he will give a speech to the United Nations, and appeal for Japan to be given a permanent seat on its Security Council. Japan has long sought one, but Mr Koizumi hopes that his push to expand its peacekeeping role will help his case.

Highlighting Japan's quest to reclaim the islands should also go down well domestically. More than 8,000 of the Japanese who fled when the Soviets moved in are still alive. They make a handy backdrop to Mr Koizumi's nationalist pose. Russia has little interest in giving the islands back, however. Its foreign ministry, which was not amused by Mr Koizumi's maritime adventure, growled that it would not introduce "a constructive element in bilateral Russian-Japanese relations".

Japan is the powerhouse of the region, but has little leverage with which to press its claim. Although it is the biggest investor in Russia's Far East, this benefits Japan as much as Russia. Japan relies heavily on imported fossil fuels, and is keen to keep them flowing through as many channels as possible. It is thus investing eagerly in oil and gas projects on Russia's Sakhalin island, and has been pleading with Russia to direct a proposed $10 billion oil pipeline to the nearby port of Nakhodka.

If Japan really wants that Security Council seat, moreover, it cannot afford to spoil relations with a country that already wields a veto. Mr Koizumi, sometimes known as Lion Heart, may gain popularity by roaring at the Russian bear. But when Mr Putin visits next year, both men will still want to talk oil, gas and money.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD ASIA

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Corruption in China

Shooting the messenger

Sep 2nd 2004 | BEIJING
From The Economist print edition

A whistle-blower blown

FOR years, China's most senior leaders have given warning of the perils of official corruption, comparing it to a spreading cancer, and suggesting that the battle against this scourge constitutes “a life-or-death political struggle for the party and the nation.” As recent events have demonstrated, for the Chinese officials fighting corruption, it can indeed become a life-or-death affair.

The official media reported a bomb blast in late August in the northern city of Xingtai, at the home of the director of the municipal anti-corruption bureau. The explosion, which tore both legs off the wife of the director, has sparked public calls to do more to guarantee the safety of corruption investigators.

Only weeks earlier, a county-level Communist Party chief from Fujian province had captivated Chinese readers with his own stirring tale of facing down threats as he dug to the bottom of an allegedly crooked re-development project. In an open letter published on August 11th on the website of the *People's Daily*, Huang Jingao, party secretary of Lianjiang County, told how he rewrote his will, and wore a bullet-proof vest for years, because of death threats he received from the subjects of his investigation.

Even more stunning was his account of the difficulties he faced in getting co-operation from other officials. He had expected “vigorous support” from his colleagues and superiors, but instead he “ran into all kinds of obstructions, as if a large, invisible net was trying to cover up this corruption case,” Mr Huang wrote. Internet readers were quick to post comments in support of the beleaguered Mr Huang. Other state-run papers carried accounts of his open letter, and editorialised about the importance of heeding his call to break down the “political taboos” that keep Chinese officials from dealing with the issue.

It seemed like a badly needed dose of honesty on a vital topic. But apparently it all went a bit too far in the eyes of the nation's ever-cautious censors. After a three-day flurry of attention, the media were ordered to stop reporting on Mr Huang and his letter. The Chinese internet has been largely scrubbed of his name. His superiors in Fujian, meanwhile, accused him of making a grave political mistake by publishing his letter, violating party discipline and threatening social stability.

Since taking office, China's top leaders, President Hu Jintao and Wen Jiabao, the prime minister, have pledged greater responsiveness to the everyday concerns of the people, and there are few if any issues which affect—and infuriate—so many in China as corruption. Farmers and urban entrepreneurs alike are subject to the rampant demands of petty officials.

Messrs Hu and Wen could do much to bolster their legitimacy by making genuine progress in tackling corruption, and they could do worse than learn from the experiences so frankly described by Mr Huang. Failure on this front is sure to result in the continued erosion of the legitimacy of the party itself. According to China's top prosecutor, investigations were launched into more than 21,000 new corruption cases during the first half of this year. There was a rise of nearly 7% over the previous year in the number of cases involving 1m yuan ($120,000) or more. But rooting out the problem will be a great deal harder than neutralising a critic and deleting a batch of internet postings.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD ASIA

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

China

The road to Beijing

Sep 2nd 2004
From The Economist print edition

A phrasebook for the 2008 Olympics

“LET'S drink to the success of the Olympic Games! Cheers!” This, it seems, is what the Chinese government wants to hear from foreigners, and in flawless Chinese, too. To that end, it has drawn up a handy new phrasebook “Basic Chinese 100 for Beijing 2008 Olympic Games”, which will allow novice Chinese speakers to render such phrases, not to mention praises.

The phrasebook is China's latest propaganda tool: colourful, slick and heavily subsidised. The book, edited by the Beijing Organising Committee for the Games of the XXIX Olympiad and the National Office for Teaching Chinese as a Foreign Language, will be distributed globally to promote a conveniently stripped-down version of the Chinese language for visitors to the games.

Judging by the tone of the book, China is expecting to blow the world away with its Olympic extravaganza. After careful study of its pages, sentences like “the sports facilities are very good, everything is exceptionally well organised and the service is great” should simply roll off the tongue.

Phrasebook users will get up to speed on the lingo through the adventures of an American tourist called Mike. From simple greetings to room service, public transport to poetical observations (“The sky is bluer, the water is clearer and Beijing is becoming more and more beautiful”), millions of Mikes will be equipped to say just the right things. As with Orwell's Newspeak, dissent is impossible, since there are no words in which it could conceivably be expressed.

Beijing's city authorities have already started teaching English to taxi drivers, policemen, and ordinary citizens to ensure the communication effort goes both ways. With Athens now over, the world is turning its attention to Beijing, and there is no time to waste.

The next Olympics will crown 30 years of economic reform in China, and the government hopes they will be recognition of its pretentions to be a great power. By 2008, China aims to have spent $37 billion on the games, dwarfing the $8.7 billion spent by Greece. Small wonder that the organisers assume that Beijing 2008 will be a success, well worthy of a florid toast.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Australia calls an election

The truth game

Sep 2nd 2004 | SYDNEY
From The Economist print edition

Iraq, the economy and honesty will dominate the campaign

Get article background

WHEN John Howard, Australia's prime minister, called a general election for October 9th, he said it would be an election about trust. Mr Howard, seeking what would be an extraordinary fourth term for his conservative coalition government, was talking about the trust his government deserved for its impressive management of Australia's booming economy. But Mark Latham, leader of the opposition Labor Party, signalled that his campaign would focus on another form of trust: he will be making much of accusations in recent weeks that the prime minister has been untruthful. The election's outcome could well rest on which sort of trust voters take more seriously.

The Labor Party received a boost to its case two days after Mr Howard announced the election. Russell Galt, a former senior official in the Liberal Party, which Mr Howard leads, said to a commercial television network on August 31st that George Brandis, a Liberal MP, had described Mr Howard as a “lying rodent”.

Mr Brandis denied the allegation; but it is unlikely to disappear. It related to the so-called “children overboard” affair which has resurfaced from the previous election campaign, three years ago. Then, Mr Howard charged that asylum-seekers had thrown their children from boats into the sea to force the Australian navy to take them aboard. Mike Scrafton, a senior defence adviser at the time, reported to a parliamentary inquiry on September 1st a charge he first made last month: that he had told Mr Howard three days before the 2001 election that the evidence failed to support his claim. Yet Mr Howard repeated it the very next day.

None of this will help Mr Howard, especially as it follows a weighty statement last month from 43 distinguished former defence and diplomatic chiefs accusing Mr Howard of “deception” over his commitment of troops to the Iraq war. Mr Howard's enemies hope that he will follow Spain's Popular Party into Iraq-induced electoral oblivion. And indeed, Mr Howard's decision to schedule his election for a month before the American presidential one looks very like an attempt to avoid momentum building up behind the dumping of warriors, in the entirely plausible event that George Bush loses.

The prime minister also faces an opposition that looked permanently out for the count until Mr Latham took over the Labor leadership 10 months ago and vigorously revived the party's fortunes. At 43, and an MP for only 10 years, Mr Latham has captured voters' attention with his brand of bold, unpredictable politics. He has carefully narrowed any differences between Labor and the coalition on economic policy, focusing instead on issues where he has managed to steal the agenda from Mr Howard, such as children's welfare and reforming an unpopular, overly-generous parliamentarians' pension scheme.

Last month, Mr Latham also contrived to upstage Mr Howard over a free trade agreement the government had secured with America. The prime minister has reluctantly agreed to accept Mr Latham's amendments, which were designed to safeguard Australia's subsidised pharmaceutical drugs scheme.

Opinion polls since May have given Labor an election-winning edge, after the distribution of preference votes. But no one is writing Mr Howard off just yet. At 65, and after 30 years in politics, eight of them as prime minister, he is Australia's sharpest politician. With economic growth running at 4% and low inflation, interest rates and unemployment, Mr Howard will tell Australians their unprecedented prosperity would be threatened under the untested Mr Latham. He has bluntly denied charges against his credibility, and accused Labor of dragging up old issues that bore Australians. If he is right, he could still join only two other Australian prime ministers, Robert Menzies and Bob Hawke, in winning a fourth term.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Iraq

Can Muqtada al-Sadr now become a peaceful politician?

Sep 2nd 2004 | BAGHDAD
From The Economist print edition

Reuters

If the Shia firebrand were to eschew violence and embark on electoral politics, he might do rather well

AFTER weeks of bitter fighting for control of Najaf, the Shias' holiest city, and in the Shia slums of Baghdad, an edgy peace now seems to be holding. But it is unclear who has come out on top. Probably not the interim government of Iyad Allawi, which failed to squash the turbulent cleric Muqtada al-Sadr and his militia, which had taken over the Imam Ali mosque, Najaf's most cherished shrine. Instead, it was the frail Grand Ayatollah Ali al-Sistani, who, despite his repeated disavowal of worldly political ambition, proved able to calm things down and fix a truce. What does this say about the respective powers of Iraq's three most prominent Shias—Mr Sadr, Mr Allawi and Mr Sistani? Who, really, has the beef?

Some disciples of Mr Sadr say they follow him because he is the only notable cleric who can lead a resistance against the American occupiers. Others say they follow him out of loyalty to his martyred father, an ayatollah who led a Shia religious renaissance before his murder, apparently by agents of Saddam Hussein, in 1999. A few say openly that the charismatic young preacher is a *wali*, a term the Shia use for leaders they consider divinely inspired.

In short, Mr Sadr is not obviously cut out for party politics. In an opinion poll in May, 64% said his insurrection had helped unite the country, but only 2% favoured him as president. Until now, both Mr Sadr and his main rival for primacy among the Shias, Mr Sistani, have chosen to exercise their influence from outside the formal halls of power, Mr Sistani by issuing lofty proclamations, Mr Sadr through fiery sermons, street marches and the odd revolt.

Now, however, Mr Sadr says he is willing to enter the political arena, if not necessarily as a candidate himself, then at least as a political movement's leader. On August 30th his spokesmen told his followers to stop shooting foreign troops and Iraqi soldiers and police serving under Mr Allawi's government and to stand by to receive the movement's programme. This statement met the government's conditions for ending the fighting in Najaf, including—in theory—Mr Sadr's Mahdi Army laying down its weapons and turning itself into a political party to compete in the general election due in January.

Some Iraqis doubt that Mr Sadr can ever be brought into the political fold, tainting his messianic image

with stump speeches, mundane policies and deal-making. His zealots would never, they say, line up meekly at polling booths. Besides, many Iraqis suspect that his Mahdi Army, having wriggled out of a corner with a peace deal, have stashed their weapons away at home in readiness for the next attempt at grabbing power by force.

But maybe Mr Sadr feels that his violence has now accomplished all he needs. He has made the point to his more hawkish followers that Mr Allawi has no authority over him. He ended the stand-off by direct negotiation with Mr Sistani—and not on the terms of a government he has in the past called illegitimate. His followers have shown what they can do if anyone tries to touch their leader.

Moreover, the fighting may have bolstered his popularity. Some Shias blame him for turning Najaf into a battlefield, but others believe the Mahdi Army's claim to have defended the Imam Ali shrine against American might. Many of Mr Sistani's followers accept that claim—and admire Mr Sadr's stand.

But how deep is Mr Sadr's support? Many Iraqis disparage his movement as a mob of jobless young men. But his support in the north-eastern slums of Baghdad, known as Sadr City after his late father, extends to quite a few other strata of society. Many shop windows bear his picture; elderly matrons name their roadside tea stalls after him. Even under Mr Hussein, clerics loyal to his family name courted the 2m-odd people of this vast and largely Shia slum. Immediately after Mr Hussein fell, Sadrist mosques arranged for lorries to bring in drinking water and got vigilantes to patrol the streets against looters.

Surging SoliSadrity

During the siege of the past three weeks, much of Sadr City seems to have united behind the Sadrists. Women got together in each other's homes to cook for the militiamen, while doctors formed mobile medical teams. If Mr Sadr were to present a slate of candidates to stand for parliament, it would get a lot of votes from this densely populated district alone.

Mr Sadr has yet to issue a manifesto, but it is most likely to demand the swift withdrawal of foreign forces. His people in Sadr City are negotiating for the entire district to be declared a no-go area for American troops; the Sadrists have stated before that elections are impossible under occupation. If a Sadr-dominated anti-occupation movement took off, with the prospect of a chunk of seats in parliament, other would-be Shia populists, such as the Americans' former favourite Ahmed Chalabi, might try to join: he was pondering just such an alliance before the fighting began three weeks ago.

The two main established Shia parties, the Supreme Council for the Islamic Revolution in Iraq and the Dawa party, detest the Sadrists, but have been upstaged by Mr Sadr's uprising; their ability to mobilise the masses in post-Saddam Iraq has not been tested. Mr Sistani is said to despise Mr Sadr but has so far avoided endorsing any political group, seeking instead to present the image of a united scholarly establishment. Mr Allawi, for his part, relies on American firepower to fight the Sunni insurgents and has every reason to keep the Sadrists down, but his officials say he is not competing with anyone: his government is a caretaker, they say, that must just get Iraq through to a real election.

Meanwhile, the Sunni insurgency continues with unabated ferocity. This week a dozen Nepalese cooks and cleaners, working for a Jordanian company, were slaughtered in an effort to scare away foreign workers, while two kidnapped French journalists were under threat of execution at the hands of another group.

If Mr Sadr does embark on peaceful politics, curbs his people's excesses and brings stability rather than upheaval, he has two advantages: a genuine mass following and a real chance to set the agenda and tone for a debate ahead—about the sort of society Iraq ought to be.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Israel and Palestine

The return of the suicide-bombers

Sep 2nd 2004 | TEL AVIV AND RAMALLAH
From The Economist print edition

For Israelis, a lull in the violence is over; for Palestinians, it never began

Getty Images

A bloody end to the lull

AFTER almost four years of the Palestinians' latest *intifada* (uprising), Israelis had been enjoying a relatively peaceful summer lull. They had suffered no suicide-bombs since one killed 11 people in the port of Ashdod in March, compared with last year's 23 deadly explosions of that kind that left 139 Israelis dead. Tourists had begun to return to the Holy Land. Israelis seemed more excited about their country's first Olympic gold medal—for windsurfing. Plainly, the idyll could not last. Brutal reality—and the angry political wrangles that come with it—is back.

This week, two Palestinian suicide-bombers blew themselves up, within seconds of each other, in buses in Beersheba, the biggest town in the Negev desert, killing at least 16 people and injuring nearly a hundred. The Islamist movement, Hamas, said it had done the deed—in revenge for Israel's assassination earlier this year of its leaders, Sheikh Ahmed Yassin and his successor, Abdel Aziz Rantisi.

As usual, the Israeli authorities promised to hit back. As a foretaste of things to come, the house of one of the perpetrators, both of whom hailed from the West-Bank city of Hebron, was demolished. Assassinations of prominent Hamas people are expected. The Israeli government made dark hints that it held the Syrians, among others, to be responsible for the bombs.

The bulldozer may be blocked

For Ariel Sharon, Israel's prime minister, the carnage only compounds his growing political troubles—and puts another question-mark over his controversial plan to evacuate the Gaza strip, the lesser of the two parts of a would-be Palestinian state. So far, however, he still seems determined to go ahead, despite the misgivings of most members of his ruling Likud party and of several leading cabinet colleagues.

Last month they had scuppered his scheme to bring the opposition Labour Party, headed by Shimon Peres, into a coalition government already weakened by defections in protest against the withdrawal idea. So Mr Sharon called off negotiations to rebuild his coalition. Instead, to keep up the momentum, he presented a more detailed withdrawal plan, including a timetable for the legislation preceding it.

A bill to compensate the 8,000-odd Jewish settlers to be evacuated from Gaza will be put to parliament on November 3rd. After it is signed into law, a decision to start dismantling the settlements will have to be endorsed in cabinet, perhaps in December. That is no formality. Several of Mr Sharon's colleagues—Binyamin Netanyahu, the finance minister, to the fore—may be tempted to trip him up, with a view to taking his job. The timing and procedure of the actual withdrawal are still uncertain.

Even if he overcomes these political hurdles, the dismantling of settlements, if and when it begins, will ensure that bitter wrangling continues. The settlers' lobby is one of the strongest in the country. If the evacuation is violent, the public mood, which is still behind Mr Sharon, despite the doubts within his own party, may change. More Palestinian suicide-bombs could further undermine him, as Israelis complain that their willingness to give ground is rewarded only by terror. Mr Sharon may try again to widen his coalition. But if that fails again, he may be tempted to call an early general election, perhaps in the spring.

That would be risky too. It is not certain, for instance, that the populist Mr Netanyahu, a former prime minister, would line up behind the 76-year-old Mr Sharon. The Likud could split—or oust Mr Sharon from its helm, though he is still popular among Israelis at large. His next few months will be tough. One of the few issues on which he can rally most Israelis is the security barrier that cuts through the West Bank: more suicide-bombs would probably speed up its construction. The latest bombers, Israelis note, crossed over from an area with no barrier.

Meanwhile, the Palestinians never had a summer lull. Since the beginning of April, some 345 of them have been killed, mostly by Israeli soldiers. More than 3,000 Palestinians in Israeli prisons have been on hunger strike since mid-August, demanding better conditions. Palestinian officials say that the militants' relative quiescence is not because of the barrier but because of negotiations, via Egyptian diplomats, to ensure an orderly withdrawal of Israelis from Gaza when the time comes.

But Palestinian frustration and misery are as strongly felt as ever. Mr Sharon, it is pointed out, has promised even in the past few weeks to build more houses in existing settlements on the West Bank, thereby increasing fears that a withdrawal from Gaza would be matched by a deeper entrenchment in the West Bank itself.

In any event, it is hard to say whether the current *intifada* has run its course, due perhaps to a mix of Palestinian exhaustion and Israeli security measures, the barrier included. Last week Arun Gandhi, a grandson of India's independence leader, led a demonstration beside a completed section of the wall, demanding its removal and an end to violence. Both, for the foreseeable future, look as unlikely as ever.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Angola

The long slow walk to normality

Sep 2nd 2004 | LUANDA
From The Economist print edition

Angola has peace. Now it needs democracy

Get article background

HISTORICALLY, Angolans have had little say in who ruled them. Their president, José Eduardo dos Santos, has been in charge since 1979. He and his party, the MPLA, have only once submitted to a proper nationwide election, and that was 12 years ago. So the announcement last week that another poll will be held in September 2006 was long overdue.

The last polls, in 1992, took place during a brief outbreak of peace. Then, Mr dos Santos and the MPLA beat Jonas Savimbi, a bloodthirsty rebel leader, and his movement, UNITA. On learning the result, Savimbi stormed back to the bush for another miserable decade of fighting.

Things are different now. Savimbi died in a blizzard of bullets in 2002, ending 27 years of war. UNITA's new leader, Isaias Samakuva, is turning the band of guerrillas into a political party. Nobody thinks the country will go back to war.

The MPLA, once committed to one-partyism, has grown more tolerant. It has agreed to ditch Marxist bits of the national anthem and let the Soviet-era national flag be designed anew. Rival politicians even shared a rare press conference last week and talked about reconciliation.

The government says it is doing its best to mend a shattered nation. Ministers say that corruption is declining. This is hard to prove, and would in any case be from a spectacularly brazen level. It helps, however, that figures (albeit imprecise) for oil revenues are now published yearly.

The economy is booming, thanks to peace and high oil prices. GDP is expected to grow by 13% this year. Investors are spreading mobile-phone coverage to the provinces. Hydro-electric plants, commercial farms, breweries, domestic airlines and diamond mines are also opening. Inflation is down from quadruple figures in the mid-1990s to double digits. Food is more affordable for the poor.

Politicians in Luanda, the capital, say they are confident that life is improving, and that voters will recognise this. They point to new office buildings, low-cost housing, street lighting and South African fast-food chains in the city. But the slums are still awful, and the beggars still numerous. Riots broke out this year when police tried to close sprawling, unofficial markets.

The World Food Programme (WFP) says shifting food in peacetime Angola is five times more costly than in warring Sudan. Roads and bridges are in a terrible state, and the task of de-mining Angolan soil will take years. The WFP still feeds 1.1m Angolans, and has just cut rations by half after the government banned the import of genetically modified grain.

Quantifying Angola's progress is difficult. No one knows how many Angolans there are, not least because so many were displaced during the war. Perhaps 70% of Angolans are under 24, so have no experience of voting. Setting up a trustworthy voters' roll will be hard.

The election will probably go ahead anyway. The ruling party may do worse than it expects. Rural Angolans, especially, are disgruntled. They see the ruling party as grasping and occasionally thuggish. UNITA blames a pro-MPLA militia for violent attacks on its offices and supporters. Former UNITA soldiers grumble that the government promised them tin roofs for their mud houses when they laid down their arms, but broke its promise.

A provincial governor says the problem is that the national government gives him almost no funds. Yet somehow, he finds cash to spruce up his palace. The national government, in turn, blames foreign donors for being stingy. But with oil 40% dearer than last year, it is not really short of money. Donors will perhaps chip in more if the election goes smoothly.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Equatorial Guinea

Will the “coup plot” thicken?

Sep 2nd 2004 | MALABO
From The Economist print edition

More twists in a tangled tale of murk and hypocrisy

THE president of Equatorial Guinea, Teodoro Obiang Nguema Mbasogo, is used to deferential media coverage. State radio in his tiny fief has likened him to God. Journalists from elsewhere have tended to ignore him. So he has no idea how to deal with all the critical attention he has attracted in the past week.

In March, his government claimed to have foiled a coup attempt. Nineteen suspected mercenaries were arrested in Equatorial Guinea itself. Another 70 were detained in Zimbabwe, where their plane had stopped, allegedly en route from South Africa to Equatorial Guinea. But what most excited the world's press was the arrest, last week in South Africa, of Sir Mark Thatcher, the son of the former British prime minister, on suspicion of having helped to finance the alleged plot. On August 31st, the trial of the men nabbed in Equatorial Guinea was adjourned for a month to see if Sir Mark, who denies involvement, has anything interesting to say.

President Obiang gave a press conference, at which he spoke for less than three minutes and took no questions. He called the alleged mercenaries “men without morals”, but insisted that they would receive a fair trial and the appropriate “condemnation”. Soldiers then shooed the reporters away.

The government is keen to portray itself as the victim of a cynical foreign plot to grab Equatorial Guinea's oil. It might attract more sympathy if Mr Obiang had not himself seized power in a coup, and if his cronies did not hog the petrodollars so flagrantly. The recent discovery of oil may have made Equatorial Guinea less stable. Power is more enticingly lucrative, and Guineans resent their unchanging poverty.

The saga has had repercussions elsewhere in Africa. South Africa, where the plot was said to have been hatched, is keen to shed its reputation as the continent's mercenary capital. Whether or not he is convicted, Sir Mark's arrest will doubtless prompt would-be privateers to take South Africa's new Foreign Military Assistance Act, which bars mercenary activities, more seriously.

But much as it would like to deter future coup attempts, there is a limit to how far South Africa's relatively liberal government can co-operate with thug regimes such as that in Equatorial Guinea. Politically, it would be hard to extradite anyone to a country where torture is common and the death penalty enthusiastically applied.

Even in Zimbabwe, justice is likely to be fairer. Last week, Simon Mann, the alleged ringleader of those arrested there, was found guilty of trying to buy arms, which he said were for guarding a mine in Congo; 66 of his companions were acquitted, though they pleaded guilty to immigration violations.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

France

A tragic twist of the scarf

Sep 2nd 2004 | PARIS
From The Economist print edition

AP

The kidnapping of two newsmen in Iraq turns a domestic problem into an international crisis, testing France's relationship with Islam

THE coming into force of a ban on headscarves (and other conspicuous tokens of faith) in French schools was always going to cause tension. But nobody foresaw a full-blown crisis whose human and diplomatic effects have stunned the nation.

The kidnapping of two French journalists by the Islamic Army of Iraq, which demanded an end to the headscarf ban, prompted a massive diplomatic effort to secure their release. The newsmen, along with their guide, went missing in late August while travelling from Baghdad to Najaf. Both are freelance Middle Eastern hands, who report for various media including the newspaper *Le Figaro* and state-owned Radio France Internationale. Not until they appeared on the al-Jazeera television channel this weekend was their kidnappers' demand known. The group set, and later extended, a deadline for France to comply. It had previously executed an Italian journalist, Enzo Baldoni.

The French government has reacted swiftly. President Jacques Chirac made it plain in a televised address that the law would stand. While not bending to the kidnappers, the French strategy has been twofold: to isolate the hostage-takers by inviting a show of Muslim condemnation and, second, to use various channels to try to secure the journalists' release. To these ends, Michel Barnier, the foreign minister, flew this week to Egypt, Jordan and Qatar; a diplomatic envoy went to Iraq.

On the first count, the French seem gratified by an overwhelming show of support. There had been concern earlier this year that the Muslim world would see the headscarf ban as an attack on Islam. Some Islamist groups, notably those close to the Muslim Brotherhood in Egypt, called for protests against France. Veiled women took to the streets in Beirut, Cairo, Tehran, Gaza and Amman. The worry in France was that this resentment could wreck the influence the country had gained by opposing the war in Iraq. (A year ago, a Gallup poll in Iraq put Mr Chirac's rating at 42%, against 29% for George Bush.) This week, however, even as the ban came into force, Muslim support flowed in. Abroad, those calling for the journalists' release included political leaders such as Jordan's King Abdullah, but also militant Islamist groups such as the Palestinians' Hamas. The Muslim Brotherhood, hard-line Salafist groups in Iraq and prominent Sunni religious leaders, all echoed the appeal, as did al-Jazeera television.

At home, French Muslims put aside their differences. Dalil Boubakeur, moderate head of the French Council of the Muslim Faith, held a joint prayer meeting, attended by the centre-right interior minister, and Bertrand Delanoë, the Socialist mayor of Paris, as well as tougher Muslim leaders. Mr Boubakeur said he was “appalled” by the kidnappers. More impressively, they were also denounced as “enemies of Islam” by Lhaj Thami Breze, a more militant figure who heads the Union of French Islamic Organisations (UOIF)—which is close to the Muslim Brotherhood—and who had called for defiance of the headscarf ban.

Some Muslim girls will still turn up for school this week with heads covered. But they would be more numerous if the hostage crisis had not happened. The UOIF's Mr Breze now says the law should be respected, while calling for a mild interpretation, to allow a modest head-covering. An issue which had split France's 4.5m Muslims seems, oddly, to be uniting them.

The second bit of the French strategy was far less certain of success. A special team has been sent to Iraq, reportedly including Philippe Rondot, a general who helped to negotiate the release of hostages in Lebanon in 1986. Yet little is known about the Islamic Army or its real motives. While France is pleased that it has not exhausted the Muslim sympathy it won during the Iraq war, it is not clear that any of its friends have any sway, direct or indirect, over the captors.

Whatever the hostages' fate, the crisis has underlined the vulnerability of France to Islamist terror. Some French commentators have been indignant, as if their stance on Iraq should have offered them immunity. “In the light of its position on the Iraq war, France could have hoped to be sheltered,” commented *Le Figaro*. The government similarly stressed its hostility to the American-led occupation as grounds for preferential treatment. In Iraq, said Mr Barnier, “France has always pleaded for the independence, the sovereignty of this country and supported its people and their suffering.”

Yet, in truth, France has few illusions about its exposure. After the Madrid bombs in March, President Chirac warned the nation it was “not sheltered from terrorist acts”. Security was tightened across the country, home to Europe's biggest Muslim population. What irks the French is the idea, implied in comments made by Iyad Allawi, Iraq's prime minister, that they might be naïve on terror. He said the French were “deluding themselves” if they thought they could remain untouched.

Indeed, many in France feel groups like the “Islamic Army” are a by-product of the general ferment caused by the war. At a Franco-German-Russian summit this week, Russia and France firmly agreed; they had stood together against the war and were united again in feeling its effects. But for France, this is cold comfort.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Terror in Russia

No end to it

Sep 2nd 2004 | MOSCOW AND NAZRAN
From The Economist print edition

Violence in Russia says more about failure at home than global terror

AFP

Chirac and Putin: in this together

WHENEVER the feuds of the Russian Caucasus turn into a hideous drama affecting hundreds of previously uninvolved people, only two things are certain. One is that Russia's rulers will—as anyone in their position would—use the occasion to remind the world of their foes' incorrigible wickedness. The other is that, even in a land where manipulating events is a tradition, the drama will spin out of control, with huge, unexpected consequences.

About 350 children and adults were the unwilling players in the horror story that began unfolding on September 1st when 19 people took over a school in the town of Beslan in North Ossetia. The captors' demand was for the withdrawal of Russian troops from Chechnya, and the release of Chechen rebels captured after they had attacked nearby Ingushetia in June. The hostage-takers vowed to kill 50 children if any member of the gang was slain. In an early success for negotiations, 26 people were freed; President Vladimir Putin said the captives' lives were an absolute priority.

The outside world swiftly offered Russia the solidarity it wanted. The UN Security Council condemned the hostage-takers “in the strongest terms”, and President George Bush was said to have offered “support in any form” from America against “callous” terror.

For ordinary Russians, the incident brought chilling memories of at least seven incidents over the past decade in which Chechens have taken large numbers of hostages to draw attention to their separatist struggle. The first such drama, at a hospital in June 1995, propelled Viktor Chernomyrdin, a doveish prime minister, to prominence and led to a peace deal—though 100 people died in the rescue attempt; but a similar hospital stand-off six months later was ended with force alone. So was the siege at a Moscow theatre in 2002, in which 129 hostages died, almost all from gas used by troops.

As Mr Putin presented things, the grisly start to the school year in Beslan was the latest twist in a wider spiral of terror. All the recent attackers, he implied, have had an international flavour.

Little is known, even among people whose business it is to know, about the Islambouli Brigades, a group that reportedly claimed responsibility for this week's suicide bomb at a Moscow metro station—and last week's explosions aboard two Russian airliners, incidents that together claimed about 100 lives. The hostage-takers in Beslan have claimed allegiance to Shamil Basayev, the leader of the 1995 siege, who is himself known to have some links with international terrorists. Despite these vague connections, the recent wave of attacks is largely the result of Russia's home-grown conflict.

The plane bombs and the Moscow blast, like several others not claimed by outside groups, seem to have been planted by young Chechen women bent on suicide; one, like many “black widows” before her, had had a brother abducted by Russia's forces. The hostage-takers include people from both Chechnya and Ingushetia. In the former place and increasingly in the latter, people have suffered from the *carte blanche* given to Russia's security forces to kidnap, torture and kill people.

The only signs of the Islambouli group's existence are its two purported statements on a militant website, plus a previous one, attributed to the “Islambouli Brigades of al-Qaeda”, which says it tried to kill Pakistan's prime minister-designate, Shaukat Aziz, in July. Such evidence was, for Mr Putin, “a fact confirming the link between certain forces operating in Chechnya and international terrorism”. The leaders of France and Germany, appearing with him hours before the metro bombing and two days after a farcical election in Chechnya, were supportive. Jacques Chirac said Russia was striving for a political solution in Chechnya.

In fact, Russia's failure to do anything of the sort is part of the background to the latest attacks. Ties between Chechens and global terror exist; but blaming the latest attacks on that alone will not help.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Turkey

A Kurd on the rise

Sep 2nd 2004 | DIYARBAKIR
From The Economist print edition

A fresh voice for a war-weary people?

INSIDE the freshly-painted municipal headquarters, cheerful young officials tap on their computers as residents register complaints. “My goal is to make people feel like first-class citizens, even if we can't meet all their demands,” explains Osman Baydemir, the new mayor of Diyarbakir, Turkey's largest Kurdish-dominated city, which he dreams of turning into a “world-class” metropolis.

At least when he took office in March, such fantasies seemed thinkable. Relative peace had prevailed in the region ever since the rebel Kurdistan Workers' Party (PKK) called off its fight after the capture of its leader, Abdullah Ocalan, in 1999. The end of a war that claimed over 30,000 lives (mostly Kurdish) hastened Turkey's drive to join the European Union. Peace helped the mild Islamists who now run the country under Tayyip Erdogan to ease curbs on the Kurdish language; it also helped the previous government to commute Mr Ocalan's death penalty.

Such measures, in turn, gave people like Mr Baydemir more leeway to advocate further rights for Turkey's 12m Kurds without risking torture or jail. But hopes of a lasting peace ended on June 1st when the rebels, who now call themselves Kongra-Gel, said they had resumed battle because of the government's refusal to meet their terms—including a full amnesty for some 3,500 fighters in northern Iraq and an end to Mr Ocalan's solitary confinement.

The government will not talk to those it deems terrorists. Public opinion is hardening amid daily reports of Turkish soldiers being killed in clashes. The EU, despite its sympathy for the Kurds, has added Kongra-Gel to its list of terrorist organisations. Pressure is mounting on Turkey's largest pro-Kurd party, Dehap, to condemn Kongra-Gel publicly too. It would then be free of accusations that it is a front for the rebels, and could give millions of Kurds, among whom Mr Ocalan enjoyed much adulation, a new, legitimate representative. Mr Baydemir, a human-rights lawyer who has called for an end to all violence, could ride this wave well.

Will he seize the moment? The guerrillas seem weak. America has pledged to dislodge them from their mountain camps in northern Iraq. Factional feuds led to the defection last month of Mr Ocalan's brother, Osman, who fled to the Iraqi city of Mosul with scores of fighters, vowing to renounce violence for good. Also, senior Dehap members are daring to criticise Abdullah Ocalan for having called off the ceasefire.

Most Dehap leaders hesitate to speak out publicly for fear of reprisal from the rebels, who have many spies within the party and other Kurdish groups. Many say it was pressure from Kongra-Gel that prompted Mr Baydemir to pay a condolence visit to the family of a rebel killed in a shoot-out with security forces in Diyarbakir last month. The gesture enraged Ankara's top brass because the rebel had taken part in an attack that left a security guard dead. One of Turkey's army chiefs called Mr Baydemir's visit “disgusting”.

Mr Baydemir insists he acted to calm public anger over the week-long siege by thousands of police, backed by tanks and helicopter gunships, of a broad swathe of vegetable gardens and cotton fields where guerrillas were hiding.

Elsewhere in the south-east, the authorities have been more measured: the government is going ahead with plans to resettle and compensate tens of thousands of Kurds evicted from their villages during the war. Such moves have boosted the rating of Mr Erdogan among the Kurds. His party snatched five major south-eastern provinces from Dehap in the March polls.

Mr Erdogan, Turkey's most popular prime minister in recent times, shot to prominence as a good mayor

of Istanbul, who broke with his harder-line mentor, Necmettin Erbakan. A good model, some say, for Mr Baydemir.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD EUROPE
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

German think-tanks

Pennies for their thoughts

Sep 2nd 2004 | BERLIN
From The Economist print edition

Needed: a new sort of place for brains to make waves

WHEN a nation has produced Immanuel Kant and Georg Hegel, it seems safe to say that thinking deeply is among its strengths. But when it comes to reflections of a more practical nature, the German way of generating new ideas fails to reach the desired level of output.

Take the issue of demography. If Germany has one chronic problem, it is that of ageing. Yet when the Berlin Institute for Population and Development, a small think-tank, wanted money to study demography and its policy implications, German foundations yawned; America's Hewlett Foundation finally stepped in.

Very gradually, think-tanks are becoming a factor in Germany's public policy. But life is still hard for *Denkfabriken*, as they are called—thanks to a rigid political system and career structure. That is more than a hypothetical problem in a country where the quality of debate is declining, political parties are increasingly content-free and the media ever more populist.

It is not that Germany has never heard of think-tanks; it has more than other large European countries. Josef Braml, a researcher at the Stiftung Wissenschaft und Politik, itself a think-tank, has identified 123 not-for-profit, independent bodies aiming to influence policy. But they differ from America's equivalent, says Mr Braml.

The habit of hiring former (and future) government officials, churning out timely policy briefs with actionable advice, and catering to the media—the standard American approach—is still foreign to the world of German think-tanks. They are more like academic institutions in which eggheads pen long, theoretical treatises that go to the government, not the public.

Moreover, the various German elites are a bit like sealed castes, from which there is no easy exit. Politicians must work their way up the party hierarchy, researchers need academic credentials, and government officials are bound by civil service laws. Not much talent travels between government and think-tanks.

What is more, argues Mr Braml, there are striking cultural differences. Most German researchers cherish academic freedom and do not want to dirty their hands with politics. American think-tanks see private money as a way to stay independent from the government. To their German counterparts, public funds are a guarantee of being free of private interests—so they get their money from the state.

Yet this very dependence on the government is prompting a re-think among Germans whose job is reflection. Subsidies have been slashed, so there is no choice but to try some American tricks. Private sponsorship is one. Another is the production of relevant, timely papers which can be hawked to the press. One august body, the German Council on Foreign Relations, used to concentrate on hosting foreign dignitaries; now it aims to be more of a service provider for its sponsors.

Competition is also forcing older think-tanks to change. The move of Germany's capital from staid Bonn to dynamic Berlin has prompted some keen youngsters to start their own outfits. One such is BerlinPolis, which calls itself a “network” for the next generation. Another is the Global Public Policy Institute, which plans an American-style foreign-affairs journal.

Corporate think-tanks also play a part. On any public issue, the Bertelsmann Foundation, which controls the eponymous media group, has worthy things to say. The Alfred Herrhausen Society for International Dialogue, funded by Deutsche Bank, invites expertise from all over the world for discussions on broad topics such as the future of cities.

Will Germany's market-place of ideas ever resemble America's? Probably not, unless Germany's political system changes. It is a parliamentary democracy where strict party discipline stops legislators becoming true “political entrepreneurs” or traders in ideas. Also, Germany's firms and citizens prefer to give spare cash to cultural and social causes rather than to the churning out of ideas; this will not change fast. Nor would it help for Germany's think-tanks to copy American ones slavishly. Many of the latter have a rather short-term research agenda, because sponsors demand it. Perhaps Germany's best bet is a happy medium between the old *Denkfabriken*, chugging on government diesel, and snappy new think-tanks, using high-octane private gas. Call such bodies *Denktanks,* if you like.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Charlemagne

I understand, up to a point

Sep 2nd 2004
From The Economist print edition

Decoding a Euro-diplomat takes more than a dictionary

IF THERE is one thing interpreters working for the European Union dread, it is attempts at humour. It is not just that jokes are hard to translate; because of the time needed for interpretation, they can prompt laughter at the wrong moment. A speaker once began with an anecdote, and then mourned a dead colleague—to be met by a gale of giggles, as listeners got his joke.

The time-lags have grown worse with the expansion of the EU, to make a total of 25 countries. Finding interpreters who can translate directly from Estonian to Portuguese is well-nigh impossible. So now speeches are translated in relays, first into English and then into a third language. If only everybody would agree to speak one or two official tongues, it would be easier. Or would it? In fact, misunderstandings can abound even when all parties speak fluent English or French. Cultural differences mean that a literal understanding of what someone says is often a world away from real understanding. For example, how many non-Brits could decode the irony (and literary allusion) which lies behind the expression “up to a point”, which is used to mean “no, not in the slightest”?

The problem is now so widely recognised that informal guides to what the French or the English really mean, when they are speaking their mother tongues, have been drawn up by other nationalities. Two modest examples recently fell into your correspondent's hands. Both are genuine.

One was written for the Dutch, trying to do business with the British. Another was written by British diplomats, as a guide to the language used by their French counterparts. The fact that the Dutch—so eerily fluent in English—should need a guide to Britspeak is particularly striking. But the problem—to judge by the guide, which was spotted on an office wall in the European Court of Justice—is that Brits make their points in an indirect manner that the plain-speaking Nederlanders find baffling.

Hence the guide's warning that when a Briton says “I hear what you say”, the foreign listener may understand: “He accepts my point of view.” In fact, the British speaker means: “I disagree and I do not want to discuss it any further.” Similarly the phrase “with the greatest respect” when used by an Englishman is recognisable to a compatriot as an icy put-down, correctly translated by the guide as meaning “I think you are wrong, or a fool.”

The guide also points out helpfully that when a Briton says “by the way/incidentally”, he is usually understood by foreigners as meaning “this is not very important”, whereas in fact he means, “The primary purpose of our discussion is...” On the other hand, the phrase “I'll bear it in mind” means “I'll do nothing about it”; while “Correct me if I'm wrong” means “I'm right, please don't contradict me.”

Fog in the Channel

The British guide to what the French really mean has a narrower aim: it was written specifically for officials attending the meetings of the European Union's Council of Ministers, where diplomats haggle over legal texts. The boredom and frustration which this sort of exercise can induce comes through very clearly in the authors' sarcastic observations.

No less obvious is the fact that ideas about plain speaking do not travel easily across the Channel. As the Brits see things, a Frenchman who says “*je serai clair*”(which literally means “I will be clear”) should be understood as meaning: “I will be rude”. Also evident is the Anglo-Saxons' contempt for spectacular gestures *à la française*. The phrase “*Il faut la visibilité Européenne*”(“We need European visibility”) is rendered as: “The EU must indulge in some pointless, annoying and, with luck, damaging international

grand-standing." The British also suggest that the sentence "*Il faut trouver une solution pragmatique*" (literal translation: "We must find a pragmatic solution") should be understood as meaning: "Warning: I am about to propose a highly complex, theoretical, legalistic and unworkable way forward."

The British, the French and the Dutch are old sparring partners who know each other's little ways. So the capacity for misunderstanding is amplified when nationalities that are less familiar with each other come into contact. Often the problems are less to do with the meaning of words than with their unexpected impact on an audience. Take the European summit last December, when it fell to Silvio Berlusconi, the Italian prime minister, to try to wrap up sensitive negotiations over a proposed constitution for the European Union.

When EU leaders filed into lunch, they were braced for tough negotiation; so they were startled when Mr Berlusconi suggested that they discuss "football and women"—and that Gerhard Schröder, the German chancellor, should lead the discussion, as he has been married four times. Some European diplomats concluded that Mr Berlusconi must have been deliberately bating Mr Schröder. But when the Italian leader was questioned about his chairmanship at a press conference, he grew hot under the collar, pointing out that he would hardly have become a billionaire unless he were fully capable of chairing a meeting. And indeed his defenders say that in Italian business circles it can be perfectly normal to set a jocular and relaxed tone before a difficult meeting, by discussing last night's football, or even teasing your colleagues about their love lives.

These sorts of misunderstandings are unlikely to be erased even if all Europe's political leaders and bureaucrats were both willing and able to speak English. But ever-inventive Brussels is coming up with a solution of sorts through the emergence of "Euro-speak"—a form of dead, bureaucratic English.

The joy of phrases like "qualified majority voting", "the community method" and "the commission's sole right of initiative" is that they are completely meaningless to all ordinary Europeans—whether in translation or in the original. But, crucially, they are crystal-clear to insiders.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Prostitution

It's a foreigner's game

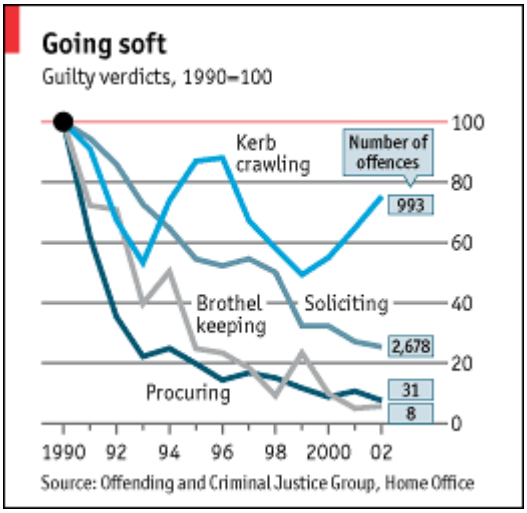
Sep 2nd 2004
From The Economist print edition

Immigration seems to be having a predictable effect on commercial sex: real prices are falling, consumption rising and indigenous workers struggling

TO GET a sense of how international the sex business is these days, consider the workforce of a small but long-established escort agency in London. Of the 30-or-so women on its books at any one time, no more than three are likely to be British-born. The rest are recruited from across the world, but especially from eastern Europe, by a far-flung network of agents. Some move to London; others "commute" between cities. Until recently, the agency's owner could offer them jobs only in Britain, but a new venture means that he can now arrange temporary placements in Paris, where the going rate is lower but, thanks to tougher French laws, the competition weaker. These days, his employees are, as he puts it, "moving and flowing all over the place".

Such disregard for national borders is characteristic of the sex industry. Having turned a profit from the internet more quickly than almost any other enterprise, it is now in the vanguard of globalisation. For prostitutes and those who make money from them, the advantages of migration and free trade are clear: wage differentials are high, English-speaking skills are not essential, and, because the whole sector is unregulated, there are no trade unions or protectionist labour laws to worry about.

As a result, London's sex workforce is remarkably international. Earlier this year, the POPPY Project, a women's housing association, telephoned saunas and massage parlours in London to ask where their employees were from. About a quarter of the workforce in 470 establishments turned out to be east Europeans—the single largest group. South-East Asia and western Europe each provided 12-13% of prostitutes, with other sizeable groups hailing from (or, at least, claiming to hail from) Scandinavia and South America. Fewer than a fifth were British. Male and transgender prostitutes, who were not surveyed, have also become much more international in recent years, according to SW5, a drop-in centre in Earl's Court.



Such a rainbow-coloured workforce has given rise to the suspicion that many prostitutes are being imported as chattels. Incidents of women and children being trafficked—brought into the country on false pretences and forced into prostitution against their will—from Russia and the Balkans help explain why several countries, including Sweden and France, have clamped down on commercial sex.

A similar clamp-down may happen in Britain. Whereas conviction rates (see chart) suggest that the police are taking a more relaxed attitude towards some prostitution-related offences—"nobody is out to criminalise hundreds and hundreds of women," says Bill Tillbrook, head of Scotland Yard's vice squad—political thinking seems to be moving in the opposite direction. A July 2004 consultation paper, "Paying the Price", asserts that many female prostitutes are trafficked into and around Britain, and cites the evident foreignness of London's prostitutes as a sign that the crime may be widespread.

Trafficking is in fact very rare, says Mr Tillbrook. The great majority of sex workers travel to Britain under their own steam, with full knowledge of what they will be doing when they get there (although, like many immigrants, they may have a rose-tinted view of their working conditions). A much smaller number fall into prostitution after finding it hard to make ends meet through more respectable jobs; for some non-EU workers, there will be smugglers' debts to repay. By far the smallest group, according to Mr Tillbrook,

consists of those tricked or coerced into the trade.

Why should so many people move to Britain voluntarily, just to work in sleazy massage parlours and sex flats? The most obvious reason is pay, but anonymity is important, too. One Swedish escort says she would never work at home: prostitution is a shameful business, and the danger of being recognised is too great. That also helps to explain why nearly all foreign prostitutes work indoors. Convictions for prostitution-related offences have declined steadily in the past decade, but streetwalkers are still much more likely to get picked up by the police than anyone else. That despised trade, which has declined in the past ten years, is now the preserve of drug-addled natives, both black and white.

The arrival of large numbers of foreign workers has certainly made life more difficult for British prostitutes. Mark, who runs Cherry Girls, a web-based referral service, says that native workers are routinely outclassed by east European women bearing good-quality photos. The escort agency owner quoted earlier is less polite. “All the agencies will tell you that English girls are unreliable workers,” he says. “As a result, they get pushed down the list.”

There is downward pressure on prices, too. The rate per hour charged by the established escort agencies has stuck at around £200 ($360) for the past three years; about 30% of that goes to the owners. The owner of a small Manchester massage parlour, who employs two women from Thailand, says that prices haven't changed much, but her employees are expected to do more for the same amount of money.

Falling real prices and better service may help explain an apparent increase in the consumption of commercial sex. According to a survey of 11,000 16-44-year-olds reported in the *Lancet* medical journal in 1990, 2.1% of men had paid for sex in the previous five years; in 2000, 4.3% had.

British prostitutes have responded to the competition in several ways. A few have set themselves up as independent operators, who cultivate an image of exclusivity and often charge above the escort agencies' standard rate. High set-up and maintenance costs make entry into this clique difficult for immigrants. Flats must be rented, web sites created, and other web sites paid to link to them. Mark, at Cherry Girls, charges £100 per link, per month; he believes that many women spend five times that on advertising.

For others, the best option is to remove themselves from the competition. Hilary Kinnell, of the UK Network of Sex Work Projects, has taken phone calls from London prostitutes complaining about the influx of immigrants and asking for recommendations on other cities to work in (as she points out to them, this is not really her job). Others go further afield, in a reverse migration. Julia O'Connell Davidson, who studies prostitution at Nottingham University, says that she has encountered British women working in the Canary Islands, albeit mostly for a British clientele. Nostalgic expatriates eager for a taste of home are a niche business; but when the home market is saturated with foreign competition, entrepreneurial Britons must take what opportunities they can.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Importing policies

Swedish message

Sep 2nd 2004
From The Economist print edition

Once Scandinavians came with swords; now they come with social policies

IF POLICIES were commodities, Sweden would have a large surplus on its trade balance. This small nation of 9m people has already exported to Britain active labour market policies, a model for universal childcare, and a merged prison and probation service. A ban on smacking children, pioneered by the Swedes in 1979 and successfully sold to 11 other European countries, was, after a struggle, voted down by the House of Lords in July. None of these policies, though, is being marketed so aggressively as Sweden's policy of outlawing the purchase of sex.

That Sweden should have developed Europe's toughest prostitution policies is odd, because the country used to be known for its liberal attitude to abortion, co-habitation and sex education. The law was changed in 1999, after ministers became convinced that the sex trade was upsetting the balance of power between the sexes. As Lise Bergh, state secretary for gender equality, explains: “We have come to see men's purchasing of women as a form of violence. It has nothing to do with sexuality.”

There were never many prostitutes in Sweden, thanks mostly to a generous welfare state. Anders Gripenlof, who works with the prostitution group of the Stockholm police, believes that, before 1999, about 250 women regularly sold sex. The new laws criminalise not them but their clients, 754 of whom had been fined by the end of June 2004. The laws seem to have worked as a deterrent. Mr Gripenlof believes there are now 50-100 prostitutes in Stockholm.

Such successes as there have been delight the Swedes, four-fifths of whom support the change in the law. Not content with having won over domestic consumers, the Swedish government is now self-consciously engaged in a battle for Europe, with the libertarian Dutch on the other side. It even has a roadshow, which begins with a showing of the film “Lilya 4-Ever”, about a trafficked Russian teenager, and proceeds with speeches from ministers, police inspectors and reformed prostitutes. Peculiarly, for a nation with such firm socialist traditions, the government has also teamed up with the White House to fund anti-prostitution campaigns in Europe. Britain's Home Office is highly impressed by Sweden's focus on the punter, and sees criminalisation as “definitely an option”, according to an insider.

Why are the Swedes so determined to spread the word? Partly it's pragmatism: the sex trade is global, and will disappear only if demand can be curtailed everywhere. Mostly, though, it is pure conviction. Sweden has long been conscious of its distinctive mission in Europe and proud of its marriage of capitalist freedom and socialist equality. Henrik Tham, a criminologist at the University of Stockholm, notes that Sweden touted its economic policies until the domestic economy ran into difficulties in the 1980s. Since then, it has marketed relatively cheap moral reforms.

Sweden's exports are not all successful. Outlawing drug taking, another modern initiative, has fallen flat. Yet the record is mostly good. At the moment, Swedes are discussing women's quotas for the top levels of corporate management and trying to do something about what ministers call the “pornogrification” of everyday life—sexy advertisements, thongs being marketed to teenagers, and so on. Such initiatives may seem off-the-wall now, but if they are floated in Britain in a few years' time, don't be surprised.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

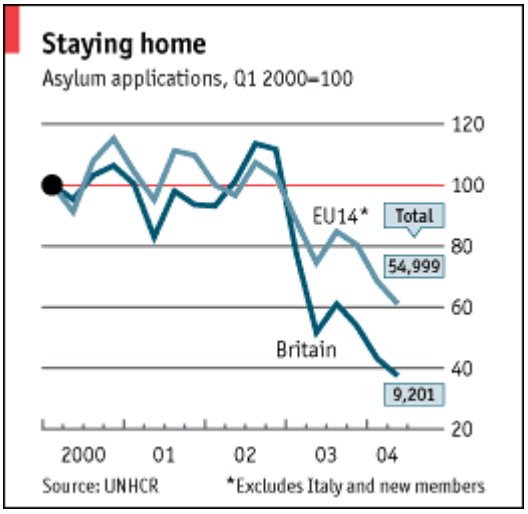
About sponsorship

Asylum

From flood to trickle

Sep 2nd 2004
From The Economist print edition

Asylum applications are down, and not just because of a worldwide decline



FOREIGNERS are a hot topic in Britain. Opinion polls consistently rate asylum and immigration as one of voters' main concerns, and right-wing parties of varying degrees of extremism have been profiting by playing up the threat to the British way of life posed by a flood of unwashed foreigners.

So a report published this week by the UNHCR will make welcome reading for the government. It shows asylum applications to industrialised countries falling sharply, continuing the downward trend of the past three years (see chart). But one statistic will be of special significance: while Britain was the most popular rich-country destination in 2003, it has now fallen into second place behind France.

So what's behind the drop in applications? One reason is simply that there are fewer asylum-seekers. The UNHCR reckons that, in the first half of 2004, the number of people seeking sanctuary in rich countries fell by 22% compared with the same period last year. Part of the drop is due to the removal of unpopular governments; Iraqis and Afghans, in particular, have stopped leaving home in such large numbers. Iraqis were the biggest single group of refugees at the start of 2003, making 11,094 applications. By the second quarter of this year that had fallen to only 2,070. Afghans have seen a similar, though slightly less precipitous, decline.

But a fall in the general level of asylum-seeking worldwide doesn't explain why Britain has lost its particular attractiveness as a sanctuary. While asylum applications in Europe have fallen by 20% in the past six months, applications to Britain are down by a 37%.

Aware of public anxiety, the government has been making life increasingly difficult for anyone trying to reach Britain. British immigration officers now conduct patrols in France, aiming to catch stowaways on trains or ferries. High-tech scanning machines have been installed in European ports to detect people hiding in cargo shipments. “We think it's the huge number of barriers that have gone up that prevent people from claiming asylum,” says Hannah Ward of the Refugee Council. “To claim asylum, you actually have to get to the UK.”

The asylum system still needs reform. Even when applications are turned down, most people are never removed from the country. The approvals process itself needs work, too: one in five of all appeals is currently upheld, and the number rises to more than 40% for Somalis, Sudanese and Eritreans, suggesting that officials are doing a bad job of processing the initial applications. But if fewer foreigners are coming, voters won't mind so much that the system is a mess.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Urban music and gays

MOBO phobic

Sep 2nd 2004
From The Economist print edition

Homophobic reggae music comes to Britain

WHEN Bob Marley made reggae music famous, the songs were about peace, love and smoking too much marijuana. But Jamaica is now exporting a new batch of reggae singers who sing some songs whose lyrics feature violent attacks on gay people. Two of them, Elephant Man and Vybz Kartel, have been shortlisted for the Music of Black Origin (MOBO) awards at the Royal Albert Hall in London on September 30th. The event will be broadcast by the BBC a few days later.

“They explicitly encourage their listeners to go out and shoot, stab, club, stone and burn lesbian and gay people,” says Peter Tatchell, a gay activist. Mr Tatchell is pushing for the MOBO awards to drop the “Jamaican murder music” from its show. That looks unlikely, but venues may be harder to find in future. This week Wembley Arena cancelled a reggae concert due to take place on Sunday, mumbling about health and safety reasons. Nonsense, say the concert's promoters: the problem was the presence of Jamaican stars.

The attention now being paid to reggae is a result of its recent success. According to the BPI, a record-industry trade association, reggae increased its market share from 0.7% of the albums sold in Britain in 2002 to 1.5% last year. This was largely due to the popularity of dancehall music, a type of reggae favoured by the controversial singers in which the bass is turned up and words are half spoken, half sung over the top. Daddy Ernie, a DJ at Choice FM, who has been playing reggae records for the last 30 years, says he has recently had “lots more requests for dancehall tunes.”

With this interest has come greater scrutiny of the lyrics. While many of the words are sung in a Jamaican patois that sounds inoffensive to the uninitiated, websites now offer translations of songs like “We Nuh Like Gay” by Elephant Man or “Boom Boom Bye Bye” by Buju Banton, which threatens gay men with a “gunshot in ah head”. These songs raise fewer eyebrows in Jamaica, where homosexuality is illegal, but have led to protests and cancelled concerts from Miami to Berlin.

Commercial logic suggests that the songs will become less offensive when written for a wider audience. Lloyd Saxon, who runs a dancehall sound system (two record players plus a couple of speakers the size of fridges) at the Notting Hill carnival, says singers “go commercial” when signed up by major record labels. Virgin, a record label, has already issued an apology from Beenie Man, a dancehall singer, for offending people “whose identities and lifestyles are different from my own”, though the wording suggests it may not have come directly from the author of “Bad Man Chi Chi [Gay] Man”.

American rappers may already be showing the way. Eminem, a rapper from Detroit, responded to similar criticism by toning down the homophobia in his songs, according to Glennda Testone of the Gay and Lesbian Alliance Against Defamation in America. He then went one better by performing a duet with Elton John, a gay singer. Watch out for a dreadlocked Jamaican singer leaning on a white piano at an awards ceremony soon.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

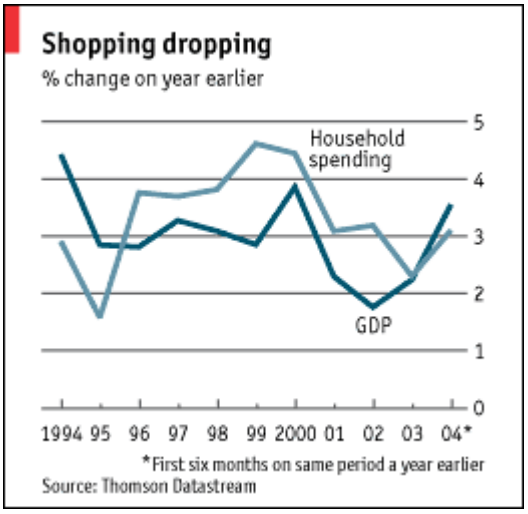
About sponsorship

House prices and the economy

Fasten your seatbelts

Sep 2nd 2004
From The Economist print edition

The housing market is turning down. It will take the feel-good factor with it



WHILE races may have false starts, the booming housing market has had false stops over the past few years. But this time the long-predicted slowdown seems to be the real thing.

Figures from the Bank of England revealed a sharp fall in mortgage-loan approvals in July to 97,000 from 112,000 in June. The decline was the biggest in over ten years. The Nationwide Building Society reported that house prices rose by only 0.1% in August, down from a monthly increase of 2.1% in July.

Earlier pauses in the housing market have occurred when monetary policy was loose and debt was lower. But since the start of November official interest rates have risen from 3.5% to 4.75% and are poised to increase to 5% this autumn. Household debt now exceeds £1 trillion and is equivalent to 135% of disposable income. With debt-servicing costs mounting sharply, the setback to the housing market is likely to be sustained.

House prices, which are still rising at an annual rate of 19% according to the Nationwide, are overvalued by any yardstick. Earlier this year the International Monetary Fund (IMF) estimated that they were a third above their underlying value. Since house prices could overshoot on the way down, that suggests a substantial decline may lie ahead.

Past experience suggests that this will inflict a lot of collateral damage on the economy through weaker household spending. The boom and bust of the housing market in the late 1980s and early 1990s exacerbated the swings of the business cycle, helping to push the economy first into overdrive and then into recession. An international study by the IMF has shown that busts in house prices last longer than stockmarket crashes and result in more lost output. That's because housing wealth is a more important determinant of consumer spending.

Adding to the worries, there are signs that household expenditure is already softening after the longest consumer boom on record. For eight consecutive years, consumer spending has grown faster than the economy. That pattern has been reversed in the first half of 2004 despite robust growth in household expenditure in the second quarter. And consumers have pulled in their horns over the summer. Retail sales fell by 0.4% in July and a downbeat survey by the Confederation of British Industry suggests that they will decline again in August.

The fear is that a downturn in the housing market will lead to a re-run of the recession of the early 1990s. But this is highly unlikely since the economy is in much better shape than it was in the late 1980s, when it had careered out of control. National output is currently around capacity, so the Bank's task is to slow growth down from its current rate of 3.7% a year to a little below its trend rate of 2.5%. With business investment recovering and a continuing impetus from the boom in public spending, this requires a slowdown in the growth of consumption but not a collapse.

The Bank is fairly confident it can achieve a soft landing for the consumer, not least since interest rates may have to rise to a peak of only 5% in order to restrain the economy. Furthermore, it now thinks the sharp rise in borrowing over the past few years has been less important in fuelling the consumer boom than it previously feared. The clearest evidence of this is that the household savings ratio has remained

broadly stable since 1998 at around 6% of disposable income—unlike the sharp decline during the housing boom of the late 1980s. Consistent with this, the household sector has been adding as much to its financial assets as it has to its liabilities.

If this is the case, how has consumer spending managed to grow faster than the economy for so long? There are two reasons, according to Ben Broadbent, an economist at Goldman Sachs. First, there has been an increase in investment income from abroad (mainly on direct investments held by British companies), which adds to the resources of consumers. Second, there has been an improvement in the terms of trade—the ratio of export prices to import prices—of about 8% since 1996. As a result, household incomes go further in the shops.

If consumers relied less on the housing market on the way up, they may be hit less by the housing market on the way down. Unfortunately, this is too sanguine a conclusion. Britain is not saving enough. It is running a current-account deficit of about 2% of GDP, which means that the country is borrowing that amount from overseas savers. And there is a looming shortfall in retirement saving. Today's retirees have been able to cash in on the increase in housing wealth, but a decline in house prices will expose the need for more thrift.

This suggests that the end of the house-price boom will indeed push up the savings ratio and depress consumer spending. Much will depend upon the speed of any correction. What is clear is that the feel-good factor will end. Even if consumer-spending growth were to fall to just 2% a year, this would still be the lowest since 1995. The good times for the British consumer are over.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com WORLD BRITAIN
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Northern Ireland

It's not much, but it's progress

Sep 2nd 2004 | BELFAST
From The Economist print edition

New talks in Northern Ireland are less important than what is unsaid

AGREEING to talk to the messenger might not seem like a great step forward for two warring parties. But in Northern Ireland, where the devolved legislative assembly at Stormont has been suspended since October 2002, it counts as progress. Most people in Belfast believe that the formal negotiations begun this week may need at least another year to produce a stable devolved government. Nevertheless, more has changed than this frustratingly slow process suggests.

The rash of bomb scares that marked the ten-year anniversary of the IRA's ceasefire, messing up Belfast traffic on August 31st, was trivial stuff compared with past violence. Dissident republican splinter groups have failed to derail the mainstream IRA and most violence is now committed by loyalist thugs with no political backing.

The political shifts have been considerable too. In 1994 the Reverend Ian Paisley said the IRA ceasefire was the worst crisis in Ulster's history. “Are we going to agree to a partnership with the IRA men of blood who have slain our loved ones, destroyed our country, burned our churches, tortured our people and now demand that we should become slaves in a country fit only for nuns' men and monks' women to live in?”, he asked. Ten years later the answer is yes: his Democratic Unionist Party is now in negotiation with Sinn Fein, the IRA's political front, albeit through British and Irish officials acting as intermediaries.

After a series of elections, Sinn Fein and the DUP have emerged as champions of their respective communities. They have trounced the moderate SDLP and Ulster Unionist parties, who now face total eclipse in the next general election. There is a growing belief that the DUP and Sinn Fein may have already decided to postpone the compromises of a settlement until they finally crush their rivals. Officials, and some politicians, have already discreetly canvassed possibilities for the two parties to share control in the ultra-sensitive area of policing.

The talks are meant to develop momentum before more talks, this time chaired by Tony Blair and his Irish counterpart Bertie Ahern at Leeds Castle in Kent, later in the month. The precedents are good: the same imposing turrets have also served as the backdrop for talks between Israel, Egypt and America that led to the Camp David accord in 1978.

In the most optimistic scenario, the jaw-jaw would hammer out guarantees from republicans that the IRA will fully decommission its weapons and wind up its racketeering. Unionists would undertake to work within the devolved government, rather than repeatedly threatening to walk out. And DUP and Sinn Fein ministers would agree to co-exist, if not deal directly with each other.

If the Independent Monitoring Commission checking on both republican and loyalist ceasefires reports in October that they have been observed, there could be an election next spring. That is a tall order. But the greatest sign of progress is that few fear renewed violence if the talks fail.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Hospital infections

Superbug scare

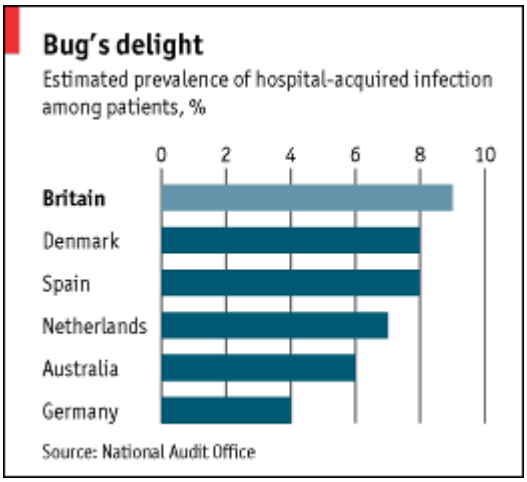
Sep 2nd 2004
From The Economist print edition

MRSA is politically damaging as well as life threatening

Get article background

OVER the past few months, the government has become increasingly confident that the National Health Service is at last responding to treatment. Ministers have been cheered by sharp falls in the number of people waiting a long time for an operation. But a nasty bug threatens to tarnish this politically vital achievement.

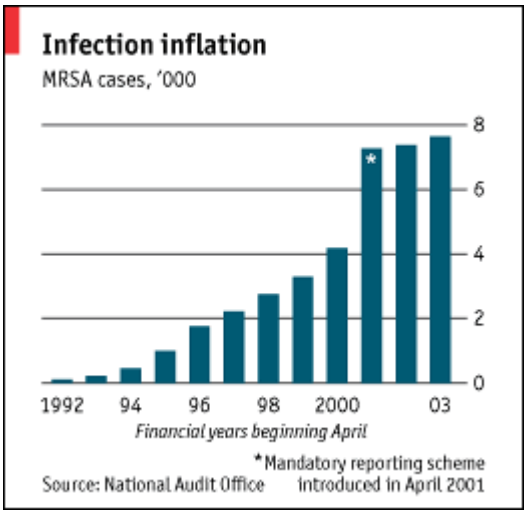
MRSA—methicillin-resistant *staphylococcus aureus*—is a common germ that has developed resistance to most antibiotics. If it gets into the bloodstream it can be fatal. The number of MRSA bloodstream infections has risen by 5.5% since 2001 to 7,647 in the past year. The number of deaths involving MRSA has increased from 51 in 1993 to 800 in 2002. Some high-profile cases have fuelled public concern. Claire Rayner, president of the Patients Association, now shuns hospitals after she caught the bug.



MRSA is one of several life-threatening infections that people can pick up in hospitals. Altogether these affect around 300,000 patients a year, causing an annual 5,000 deaths, according to the National Audit Office. That may seem an indictment of Britain's state-run NHS, but the NAO finds that hospital-acquired infection is common in many countries. The prevalence rate of 9% among patients in Britain compares with 8% in Denmark and 7% in the Netherlands.

Where the NHS scores poorly is in its record in dealing with MRSA. In Britain, about 40% of *staphylococcus aureus* blood infections are methicillin-resistant. This compares with less than 1% in Denmark and the Netherlands.

What is the NHS doing wrong? Most people's first reaction is to blame the spread of the disease on dirty wards. But poor hand hygiene by doctors and nurses is as important a reason for the spread of MRSA. This week, the government launched a new campaign to encourage hospital staff to keep their hands clean.



The Dutch have successfully used a "search and destroy" strategy. Patients are screened and those found to have MRSA are isolated. Wards and critical-care units where there have been infections are closed to new admissions.

But dealing with MRSA means making it a priority; and it has not been at the top of the government's wish-list until now. According to the NAO, about half of senior hospital managers say there is a conflict between the government's high-profile waiting-time target and scrubbing away at hospital infections. Meeting the target means high rates of bed occupancy, which increases the risk of infection and makes it more difficult to combat through techniques such as isolation.

The Labour government has lived and breathed targets. It will campaign in the next election on a pledge to reduce the maximum waiting time for an operation to 18 weeks by 2008. The spread of MRSA is another reason to doubt the wisdom of Labour's obsession with precise but treacherous goals.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Bagehot

Growing apart

Sep 2nd 2004
From The Economist print edition

George Bush is cross with Michael Howard about Iraq, but that's not all that divides Republicans and Tories

NO DOUBT the group of 20 Conservative MPs and officials who attended this week's Republican Party convention in Manhattan will feel their trip was worthwhile. British politicians, hungry for new techniques and winning ideas, are used to looking to America to provide them. And the Tories are in urgent need of both.

Tony Blair learned about the “third way” and “triangulation” at Bill Clinton's knee. William Hague, the last Tory leader but one, became briefly excited by George Bush's “compassionate conservatism”. More prosaically, Ronald Reagan introduced Margaret Thatcher to the joys of the autocue. Liam Fox, the Tory co-chairman who led the little delegation to New York, has just splashed a large amount of the party's cash on an American software package that tracks the views of individual voters in swing seats and then bombards them with targeted messages.

There is some scepticism back home whether the system can be adapted to British circumstances. But however tricky it proves to operate, the software is likely to be a good deal more useful than anything else Dr Fox's team brings back from its fraternal visit. The relationship between British Tories and American Republicans has traditionally been warm and mutually regarding; but now it is chilly and mutually uncomprehending.

The immediate cause of the estrangement is the Iraq war. Last weekend, it was revealed that Karl Rove, Mr Bush's closest political adviser, had told Michael Howard's aides that the Tory leader would not be welcome if he turned up to see the president. Mr Rove was reported as saying in a furious telephone call: “You can forget about meeting the president. Don't bother coming. You're not meeting him.” What had caused such anger in the White House was Mr Howard's apparently equivocal attitude to the war. In particular, his attacks on Mr Blair for having misled the country over Iraq's weapons of mass destruction and his suggestion that the prime minister should “seriously be considering” his position were seen as contemptible opportunism and a direct criticism of Mr Bush himself.

Revealingly, instead of trying to play down this unprecedented snub, Mr Howard opted for escalation, commenting: “If some people in the White House, in their desire to protect Mr Blair, think I am too tough on Mr Blair or too critical of him, they are entitled to their opinion. But I will continue to do my job as I see fit.” While a few Tory MPs were horrified by the implications of the spat—in particular what it said about the White House's view of Mr Howard's chances of becoming prime minister—dislike of Mr Bush is so widespread and deep-seated among British voters, including Tory supporters, that most thought it would do Mr Howard nothing but good.

Some of the Tory distaste for Mr Bush stems from his lavish praise for Mr Blair, but it goes far deeper than that. While Margaret Thatcher and Ronald Reagan might have been kindred spirits bound together by a sense of shared mission, both the world and their respective parties have changed greatly over the past 20 years. The cold war was won and so, too, was the battle for market economics. But while the American right, despite the Clinton interregnum, has grown in strength and confidence, British conservatism, demoralised by defeat, is no longer certain what it stands for.

Tory MPs to whom Bagehot has spoken estimate that at least half their number would rather see a John Kerry presidency than Mr Bush re-elected. Even one of Mr Howard's frontbench team, Alan Duncan, has expressed a preference for Mr Kerry. So too has Michael Portillo, a former leadership candidate. In a recent interview, Sir Malcolm Rifkind, a foreign secretary in the Major government and a likely leadership front-runner should Mr Howard depart after the election expected next year, argued that the Tories

should run on an anti-war, anti-Bush, pro-UN platform. Sir Malcolm—and many liberal Tories agree with him—also thinks that his party should stand up for civil liberties against the creeping authoritarianism of a Labour government preoccupied with violent crime and the threat of terrorism.

The Tories' confusion about who and what they are is largely the result of Mr Blair's ruthless ability to steal their ideas and occupy their traditional ground. Defining themselves against Mr Blair without looking silly or extreme is not easy. But even without the phenomenon of Mr Blair, today's Conservative Party would still look at Mr Bush's Republicans with a mixture of disbelief and horror. In Britain, there is no equivalent of the religious right, which dominates the social agenda of the Republican Party. The social conservatism that is the bedrock of today's Republican Party hardly exists in Britain.

Glad to be gay

In common with the rest of western Europe, Britain is essentially a post-Christian society. Religion, for the few who practise it, is a private matter. Churches here are unassuming, polite and a bit lefty. There is a small anti-abortion movement, but it is nothing like the American pro-life groups that terrorise politicians of the centre and right. There is almost no debate about stem-cell research and very little about gay marriage. The Conservatives, desperate these days to convince voters of their socially liberal credentials, are busily selecting as many homosexuals and single mothers as they can muster to contest winnable seats. Mr Rove would not know where to begin if he sought to build a successful conservative coalition in Britain.

Moderate Republicans, such as Rudy Giuliani and Arnold Schwarzenegger, have been to the fore in New York this week, and Republicans and Tories still share the same sentiments (often more honoured in the breach) in favour of smaller government and lower taxation. But nothing can disguise the fact that these are two parties heading at speed in opposite directions.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Perpetual motion

Sep 2nd 2004
From The Economist print edition

For much of the 20th century, carmaking was the "industry of industries". Now it has to reinvent itself, says Iain Carson

IT MAKES nearly 60m cars and trucks a year, and employs millions of people around the world. Its products are responsible for almost half the world's oil consumption, and their manufacture uses up nearly half the world's annual output of rubber, 25% of its glass and 15% of its steel. No wonder the car industry accounts for about 10% of GDP in rich countries.

But the industry that has pioneered the forms and weathered the storms of 20th-century capitalism is now over 100 years old, and it is struggling. Average profit margins have declined from 20% or more in its youth in the 1920s to around 10% in the 1960s and less than 5% now, and some volume carmakers have actually been losing money. Despite its importance to modern economies, the industry has all but vanished from equity markets. "It is becoming a sunset industry, a has-been in financial terms—a flagrant contrast with its continuing social role, its share of employment and its political influence," write Graeme Maxton and John Wormald in a new book, "Time for a Model Change".

A study by Deutsche Bank two years ago found that the car industry represented just 1.6% of Europe's stockmarket capitalisation, and only 0.6% of America's. Two decades earlier, the figures were 3.6% and 4% respectively. Although firms such as Ford dominate the corporate-bond market, the car companies' debt is rated as close to junk, so they have to pay dearly for this kind of finance. In Japan the picture is different because of the unusual success of the world's mightiest carmaker, Toyota, and (latterly) the recovery of Nissan under the wing of Renault.

Invented here

A century ago the car industry more or less invented modern industrial capitalism. The car started life in Germany, and early development of the industry began in France (hence automobile, originally a French word) in the 1900s, but it was in America that it came of age. Henry Ford's adaptation for carmaking of the moving assembly line he had seen in Chicago slaughterhouses marked the birth of mass production.

But Mr Ford applied those techniques to a vehicle that resembled a horse-drawn carriage, with a body laid on to a separate chassis. Modern cars have a monocoque steel body in which the strength is built into the pressed steel floor, sides and roof. It was invented by Edward Budd, taken up by Dodge and then by Citroën in Europe, and then by all volume carmakers.

Toyota may have refined the process in the 1960s by its lean-manufacturing (just-in-time) techniques, but cars are still made by stamping, welding and dipping steel, then stuffing the body with engine, trim and seats. Factories have to be large to reap the biggest economies of scale: around 250,000 units a year for assembly plants and 1m-2m units for making body panels. So Mr Budd's legacy was not only a way of making a rigid integral car body; he also laid the foundations for a whole rigid industry that some experts think is now incarcerated in its own vast plants.

Around the same time as modern car manufacturing was born in the mid-1920s, Alfred Sloan's ideas for running General Motors provided the model for the great corporations that grew up to dominate the second half of the 20th century. GM soon swept past Ford as Mr Sloan revolutionised the young car industry, and Ford has never regained the dominance it enjoyed in the infancy of mass production.

The world's top ten 1

Car manufacturers, 2003

	Global vehicle units sold, m	Sales $bn	Market cap $bn, latest
General Motors	8.59	185.5	23.3
Toyota	6.78	153.1*	136.4
Ford	6.54	164.2	24.8
Volkswagen	5.02	98.4	12.2
DaimlerChrysler	4.36	171.9	41.8
PSA/Peugeot Citroën	3.29	61.2	14.3
Hyundai Automotive	3.05	38.9	9.0
Nissan	2.97	65.8*	47.1
Honda	2.91	77.2*	46.4
Renault	2.39	42.4	22.1

*Year ending March 2004

Sources: *Automotive News*; company reports; Thomson Datastream

The car industry has been ahead of its time in many respects. Peter Drucker, a management writer who first made his name with a study of GM in 1945, coined the phrase “industry of industries”. The company was also the leader in “planned obsolescence”, the frequent changes in design that tempted customers to switch to a new model every year or so. It was the first to feel consumer anger, with the publication in the 1960s of Ralph Nader's attack on the safety record of the Big Three Detroit manufacturers, “Unsafe at Any Speed”. In the 1970s, as the oil price quadrupled, the industry found itself under attack from environmentalists outraged by its products' gas-guzzling habits.

It was also among the first to come under careful government scrutiny, from safety concerns to environmental issues to antitrust worries in the days when General Motors had 60% of its domestic market and could snuff out competitors with a few well-chosen price cuts. But it also received more welcome government attentions. When small, economical and reliable Japanese cars started to eat into Detroit's market share, the American government imposed restraints on those imports. Soon afterward, the industry in Europe came under similar pressures.

The car industry also found itself at the cutting edge of capitalism in another sense. As mass production techniques developed in the 1920s and 1930s, its workers increasingly pushed for unionisation. At times, it seemed as though the car factories of the Detroit area, the British Midlands or the huge plants around Paris were the main battleground of the class war. Even today, the United Auto Workers union (UAW) still dominates Detroit, even though trade union membership in America's private sector as a whole is well below 10% of the workforce.

Until last year the UAW's leadership seemed to have its head in the sand, oblivious to the competition that was hurting General Motors, Ford and the Chrysler end of DaimlerChrysler. Then it suddenly got the message, agreed to a moderate pay deal and accepted more closures. The union has seen its membership decline steeply over the past 20 years, but it can still make it hard for car companies to reduce overcapacity.

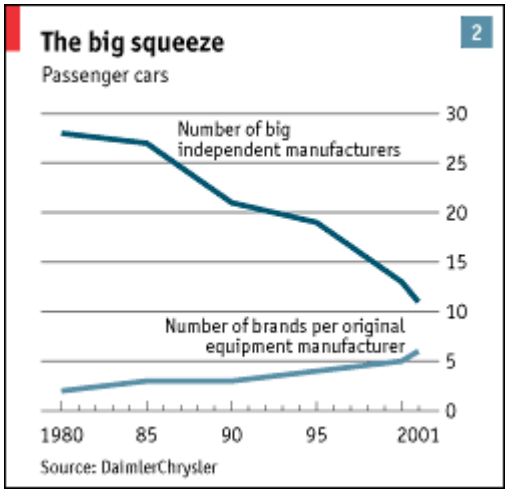
Today the motor car is the epitome of mass production, mass marketing and mass consumption, with some of the strongest brands in the world. For most households in rich countries, it is the second-biggest purchase after a house or flat. Few other consumer-goods industries depend so heavily on a thriving second-hand market for their products. And yet there are powerful forces at work that could profoundly change the industry.

One is the fragmentation of the market, leading to lower production runs. Another is dissatisfaction with the costly system of building cars for stock, not to order. A third is innovative modular construction, in which more of the car is put together by parts suppliers. And further ahead, a fourth force could be a switch to electric cars with electronic and electrical rather than mechanical controls.

A world falling apart

Right now, though, the biggest force for change is the fact that

most of the volume-car industry is broke and needs fixing. The market in America, Europe and Japan, where over 80% of the world's cars and trucks are sold, has been running out of growth. In America the arrival of European, Japanese and South Korean makers has created overcapacity. Moreover, as America's own carmakers constantly improve their productivity to catch up on these new rivals, their greater efficiency itself increases capacity by about 3% a year.



In Germany and France, rigid labour laws have inhibited the closure of redundant old factories, although Renault has set a good example, and Ford Europe and GM Europe have been trying to follow it. In Japan, the close industrial partnerships known as *keiretsu* have proved too rigid for some manufacturers. Only Toyota and Honda remain in purely Japanese hands. The smaller Japanese producers make little or no profit at home and are struggling to get into the black in Europe. Even for the big companies America provides the best hopes for growing profits.

The rest of the world presents a mixed picture. In Asia the 1997 financial crisis dealt the South Korean car industry—always a rather artificial creation—a huge blow. Today only Hyundai survives as an independent. In South America economic collapse in Brazil and Argentina put a stop to the rapid expansion of the car industries there, leaving foreign investors such as Fiat to cut their losses.

The boom in China is getting everyone excited, but it needs to be kept in perspective. For all the huge percentage increases, the annual value of that market is equivalent to just about a month's sales in the rest of the world.

All the car companies think that if only they try harder, they can somehow regain growth at the expense of rivals. But in reality they are like Scott Fitzgerald's “boats against the current, borne back ceaselessly into the past”. Add the growing pension and health-care bills of traditional producers such as America's Big Three and the Europeans, and it is easy to see why the industry is feeling under siege.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Detroit's nine lives

Sep 2nd 2004
From The Economist print edition

America's carmakers are regularly written off, but they always seem to bounce back

A DECADE ago, Paul Ingrassia and Joseph White wrote a racy book called “Comeback: The Fall and Rise of the American Automobile Industry”. It starts with the words: “This is an American success story, born of a close call with disaster.” Last year another American writer, Micheline Maynard, published a book called “The End of Detroit: How the Big Three Lost Their Grip on the North American Car Market”. Its opening sentence: “Detroit's long reign as the dominant force in the American car industry is over.”

It seems that once every decade or so America's car industry gets into deep trouble, but each time something comes along to save it. In the 1980s, the family bailed out Ford, and the federal government gave a loan guarantee that rescued Chrysler; in the 1990s, it was the boom in sport-utility vehicles (SUVs), where the government also helped with import tariffs that kept Japanese sales down.

In 1991 and 1992, GM lost a total of about $15 billion in its North American car business and was saved only by profits in other markets, mainly Europe. But after a brush with bankruptcy in 1992, GM, under a new chief executive, Jack Smith, quickly got back into the black. This Mr Smith, a quiet Bostonian finance man, eschewed the flamboyance of his predecessor-but-one, Roger Smith, who nearly drove the company into the ground in the 1980s by over-investing in factories and robots. Ford had had its own financial woes in the early 1980s, but came through in better shape than its rivals. In the early 1990s it was recovering and looked like passing GM.

Chrysler was emerging from near-bankruptcy for the second time in ten years. This time around it was nimble product development and leaner manufacturing that did the trick, not federal loan guarantees. Most of the credit for re-energising the company belonged to Bob Lutz, an industry veteran who had enjoyed a distinguished career at Ford and BMW (and who is now working his magic on GM's product development as vice-chairman). But an attempt to merge with Fiat, then healthier than now, fell through because the Italians were wary of Chrysler's legacy of pensions and pensioners' health-care costs.

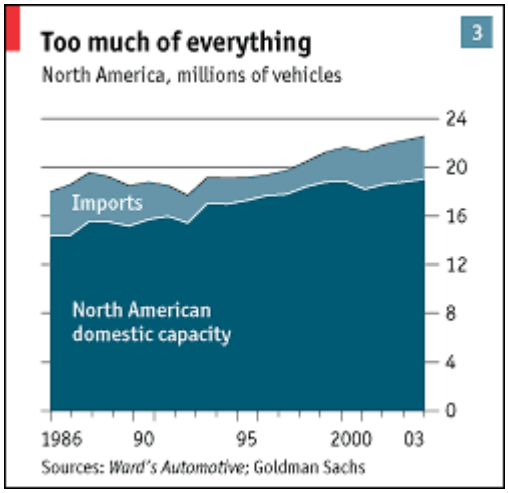
All of the Big Three were pushing into profit thanks to an extraordinary boom in demand for big pick-ups, SUVs and minivans, where they held a dominant position. These vehicles played on the Americans' traditional love of pick-ups, but stretched the concept of utility. (Oddly enough, the world's first real SUV was the Range Rover, made in Britain by a subsidiary of the now-defunct British Leyland.) Today's optimists think that the Big Three could design their salvation again.

Market of markets

The United States remains the largest single market for cars, and the most lucrative one. But nearly half the cars sold in America are foreign brands, leaving the country's three native car manufacturers struggling. Japan's Big Three (Toyota, Nissan and Honda) and the European luxury brands (Mercedes, BMW and Volvo) make their best profit margins in America. Even European brands that have never succeeded there, such as Renault and PSA Peugeot Citroën, still dream about it. Indeed, when Carlos Ghosn becomes boss of Renault as well as Nissan next year, one of his top priorities will be to take the French brand back into America, with a little help from Nissan, which is already well established in the market.

Car sales in America have been booming continuously since the late 1990s. Normally car companies make enough profits in boom years to tide them over when sales slump. But in recent years the normal rules about cyclical peaks and troughs seem to have been suspended, as sales have stayed at a high level.

After September 11th 2001, Americans stopped buying cars. In the deathly hush that followed, General Motors launched a wave of discounts and credit incentives in a campaign to “keep America rolling”. This raised the stakes in price discounting, a practice that had already been spreading for five years. GM's campaign was a great success, keeping sales ticking over nicely. Ford and Chrysler were obliged to follow suit immediately, and over time even the Japanese brands had to offer some discounts. European imports, with their upmarket brand image, withstood the pressure until this summer, when Volkswagen had to offer reductions. Since 1999, total car sales in America have averaged around 17m a year, even through the mild recession of 2001—though they dipped a bit this summer.



Some people put this down to a growing and increasingly affluent population, with the three-car garage becoming the norm in suburbia. Less starry-eyed observers think that a more pernicious process is at work. The Europeans, Japanese and South Koreans are opening new factories in America faster than the traditional manufacturers can shut down their less productive plants. The resulting oversupply has sparked a price war that is keeping up the volume of sales, at an average cost of around $3,000 per car.

In an industry with such high fixed costs, it is tempting to sell at almost any price to keep the cash coming. That is what GM did after September 11th, and everybody is still doing it today. But the imported brands get away with discounts roughly half of those that Detroit has to offer. The effects of this price war fall disproportionately on American makers, for a couple of reasons. Brands such as BMW, Mercedes, Volvo and even Volkswagen have usually commanded a premium price because they are seen as stylish. Japanese products are also perceived to be superior for their reliability and for the quality of their dealer networks. Moreover, these companies all have new or nearly new factories in America, which deliver higher quality and productivity than the American makers' older plants and are not burdened with a legacy of high pensions and health-care costs.

In this market full of discounts, each manufacturer is hoping that it can squeeze more car sales at the expense of its rivals. In fact, sales stayed artificially high only because the producers are making it attractive for consumers to swap their older vehicles for new ones. Detroit is, in effect, paying people to scrap their cars. Falling second-hand values bear this out.

While all this was going on, the bursting of the stockmarket bubble was beginning to hurt the pension funds of the Big Three. GM, for instance, has 2.4 pensioners for every employee, and Ford's retired workers also outnumber present employees. The more that these companies lay off older workers, the more they add to the burden of pensions and health-care costs. The federal government is being furiously lobbied to find some way of helping out the carmakers, just as it has helped the steel, textile, farm and airline industries.

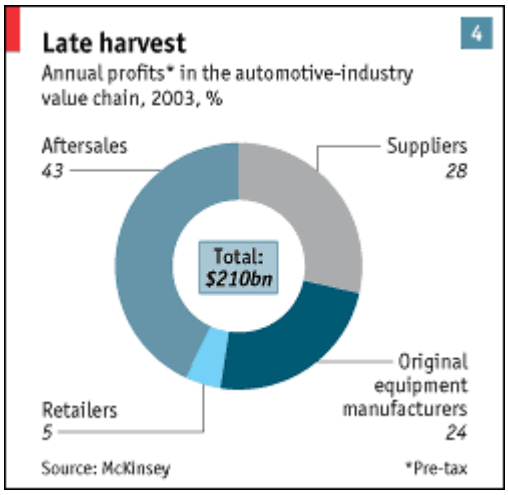
Both Ford and GM have had to issue bonds worth billions of dollars just to plug holes in their pension funds, and have had to use chunks of their profits for top-up payments. But these bond issues simply replace one form of liability with another. They do nothing to solve the underlying problem; in fact, they disguise the financial woes because the companies are allowed to assume a 9% return on the sums invested in the pension fund.

For much of last year, it was feared that Ford, in particular, would topple over into Chapter 11 bankruptcy. The company went from a profit of $7.2 billion in 1999 to a loss of $5.4 billion two years later. After Jacques Nasser, its charismatic chief executive, was fired in late 2001, the company seemed to drift as it sought to reverse the ambitious diversification strategy he had devised. Chrysler also caused a scare in the spring of last year when its parent DaimlerChrysler announced a $1 billion provision that ruled out Chrysler's expected profit in 2003. This came just as new products were supposed to be revitalising the company and at long last demonstrating some benefit from the company's merger with Daimler-Benz back in 1998.

One credit-rating agency, Egan Jones (which predicted the collapse of Enron and WorldCom), said that Ford was saved from going bust only because it was a household name. Sean Egan, founder and boss of the agency, worried that Ford relied too heavily on bonds secured against customer repayments of car loans. Raising securitised credit becomes more difficult when a flood of discounted new models hits the market, depressing used-car values and leading to yet more discounting.

With sales incentives offering interest rates all the way down to zero, the car companies eventually have to funnel money into their credit subsidiaries to balance the books, so loss-making consumer-goods makers are lending money to customers to buy their wares. They then use the stream of income from customers' repayments to secure debt from the capital market, even as they discount their new cars and weaken second-hand values. This adds risk to the stream of securitised income, as well as causing another financial headache when fleets of leased cars revert to the manufacturers every six months.

The danger in all this financial engineering is that sooner or later credit-rating agencies will become worried by this pyramid of risk. They might then conclude that the underlying business model is broken, so car companies would get shut out of unsecured borrowing and could run out of cash. It was this nightmare scenario that was facing Detroit's carmakers last year.



But now both GM and Ford can see their North American businesses turning the corner. Mr Lutz points to the success of GM's Cadillac division, which has a waiting list for some of its luxury models. Far from expecting discounts, he says, buyers are prepared to pay over the odds to get their hands on them. He aims to replicate the Cadillac comeback with other troubled GM brands such as Chevrolet and Pontiac. The company's previous divisional structure, which encouraged bureaucracy, has been scrapped. “There is now one GM,” says Mr Lutz. Engineers and designers switch from working on Cadillacs to Pontiacs without missing a beat, and duplication and overlaps have been eliminated.

Ford, which took the axe to its excess capacity in America somewhat later than GM, is still trailing its bigger rival, but both companies' financial performance has been surprisingly strong since the start of this year. Ford followed a profit of $1.95 billion in the first quarter of this year with one of $1.2 billion in the second (almost triple that for the same period last year). CreditSights, an independent investment-research firm, reckons that the opening of two rebuilt factories making upmarket models, in Dearborn and Chicago, will add $2 billion a year to Ford's profitability by 2005. But the domestic market slumped in the summer and inventories of unsold cars rose: the discounts and other incentives needed to counteract this will make the second half of this year tough for Ford, despite its sparkling beginning to the year.

GM has been telling analysts that it is on track to generate $5 billion in operating cashflow this year, with a net profit of $1 billion-1.4 billion in North America. Like Ford, GM reported rising profits in the first half of this year: both were boosted by their finance earnings.

Invasion of the model snatchers

But the biggest thing that has happened in the American car market in recent years is the expansion of the Japanese (along with the upmarket Europeans, Mercedes and BMW, and latterly South Korea's Hyundai). Through the 1990s the Japanese accounted for the bulk of $3.1 billion of direct investment in America's car industry, opening plants to make 1.1m cars a year which created 14,400 jobs. That investment attracted subsidies from the states where the plants were built (mostly in the south) worth between $800m and $1 billion, according to calculations by Maureen Appel Molot, of Carleton University in Canada, who has studied automobile investment in the North American Free Trade Area.

This comes on top of an earlier wave of Japanese investment in America in the 1980s, worth a total of $3.4 billion, which created the capacity to make 1.5m vehicles a year, and 18,700 jobs . The investment incentives then were thought to be worth between $500m and $1 billion. The average car produced in America by Japanese or European makers carries investment incentives of over $1,000. No wonder these manufacturers can get away with offering only half the $3,000 or so of sales incentives or discounts that American makers have to provide to move cars made in the old factories of the mid-west rust belt. The new “transplant” capacity is now approaching 3m vehicles a year, about one-fifth of domestic companies' capacity.

Much of the second wave of Japanese investment was in plants to make big pick-ups and SUVs, to which the incomers were new. Jeff Schuster of J.D. Power, a consumer-research firm, points out that it was the addition of such vehicles to the product range of Nissan, Toyota and Honda that allowed them to push

down the Big Three's share of their home market from 66% in 2000 to 60% last year. He expects a further slight decline for the Detroit makers, but thinks most of the loss in market share is now behind them.

American carmakers, for their part, have become heavily engaged in Japan, with Ford rescuing Mazda, and DaimlerChrysler offering a lifeline to Mitsubishi (although earlier this year the German company refused to put in a further cash injection, leaving Mitsubishi Motors to be rescued by its *keiretsu* partners). GM has poured millions of dollars into Isuzu, Suzuki and Fuji (makers of Subaru), helping them out with finance and technology. GM's share of the American market has slumped to under 30% from more than twice that at its peak 30 years ago, but the company's global footprint—including not only its Japanese interests but also Daewoo and Fiat, in which it holds stakes—covers a quarter of all car sales worldwide.

This pattern of partnerships and alliances has quietly grown throughout the past decade. Many in the industry think it makes more sense than attempting difficult mergers.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

The new European order

Sep 2nd 2004
From The Economist print edition

Mergers and deals have left Europe's car industry in a surprisingly healthy state

THE car industry has been consolidating almost since it was born. In the late 1920s there were 270 car companies, mostly in America, before the Big Three gobbled them all up. Today, with the industry fully mature, there are only seven big groups and three smaller ones. Back in 1986, the late Gianni Agnelli, who spent over 30 years at the head of the Fiat Group, forecast that by the end of the 1990s there would be only half a dozen big carmakers left worldwide. He was not that far out. In volume terms, six groups, GM, Toyota, Ford, Renault/Nissan, Volkswagen and DaimlerChrysler account for some 70% of global sales, including their affiliates.

The three big consolidation deals of recent times have all involved European companies, and have produced mixed results. BMW bought Rover from British Aerospace in 1994, seeking to reap economies of scale by roughly doubling its output to 1m vehicles, and acquiring the strong Land Rover brand as part of the deal. But because it failed to appreciate how deep Rover's problems were, it did not put them right.

Six years later, when it gave the company away to a consortium of businessmen and employees from Britain's Midlands, it was left with the successful Mini brand, manufactured in the old Rover factory in Oxford. Even though the Mini is a runaway success, it is not much to show for the $5 billion that the German company poured into its “English patient”, as Munich wags used to call it. But at least the Mini brought BMW's sales up to the 1m mark and helped it overtake Mercedes (excluding Chrysler) in global sales in the first half of this year, for the first time ever.

One reason Mercedes has been overtaken is that top management at its parent DaimlerChrysler has been preoccupied with its own acquisition problems. When Daimler-Benz announced its merger with Chrysler in 1998, the bosses of Toyota's American subsidiary held an impromptu party at their head office in the suburbs of Los Angeles. They foresaw what the Germans did not: that the sheer difficulty of a transatlantic merger would distract Chrysler and boost its competitors.

They were to be proved right, but the damage went even deeper. Last year, the combined stockmarket value of the two companies had fallen to about half the sum of their separate valuations before they

merged in 1998. The merger (which was really a takeover of Chrysler by Daimler-Benz) reduced the value of the two businesses by $28 billion. Like BMW with Rover, Daimler failed to look closely enough at Chrysler's business before tying the knot. The smallest of America's Big Three looked good at first sight, but its best-selling products were ageing, its quality was slipping and it had nothing much in the product pipeline.

Moreover, the Germans were slow to get a grip on Chrysler's management. It took them about two years to put in the engaging Dieter Zetsche, who had what it took to start turning Chrysler round. Unfortunately the company's revival coincided with the latest round of price-cutting, leading to last year's big write-off and the postponement of break-even hopes for 2003. But the latest Harbour report (a snapshot by a respected consultancy of the American car industry, both American- and foreign-owned) shows that Chrysler has made great strides, with efficiency rising by 16% in the past two years. Even so, Chrysler last year was losing a hefty $496 on every car it sold, compared with Ford's modest $48. GM was making a profit of $178 per vehicle, but was still completely outclassed by the Japanese: Honda made $1,488, Toyota $1,742 and Nissan $2,402 per car.

DaimlerChrysler's management thinks that in the longer term it will be able to reap huge benefits by transferring more Mercedes technology, parts and manufacturing know-how to revive Chrysler. But sceptics point out that the company has also been slow to turn round its Japanese affiliate, Mitsubishi Motors. Last spring DaimlerChrysler's chief executive, Jürgen Schrempp, proposed putting more money into the Japanese company to help it restructure, but DaimlerChrysler's board preferred to let Mitsubishi's Japanese *keiretsu* partners take the strain.

Fitch, one of the big credit-rating agencies, upgraded DaimlerChrysler in May, which should help the company's bonds. Analysts expect the group's pre-tax profits to recover from last year's depressed €596m ($673m) to over €5 billion this year and €7.3 billion in 2006. So after several wasted years it looks as though the benefits from the merger may soon start to flow.

The standard against which motor-industry get-togethers have been judged in the past five years has been the spectacular alliance of Renault and Nissan, which amounts to a virtual merger without the pain of fully fusing two companies. When the French group announced in early 1999 that it was taking a 37% stake in Japan's perennially loss-making second-biggest car company, virtually nobody in Japan thought it would work.

Renault renaissance

But within two years the man in charge of rescuing Nissan, the Brazilian-French Mr Ghosn, had turned it from loss into profit by closing factories in Japan and speeding up the development of more attractive cars by Nissan's impressive engineers. Once it was clear that Nissan was starting to reduce its huge debt burden, Renault increased its stake to 44%. But the two companies are keeping their separate identities in order to retain brand loyalty and employee motivation, “the fuel on which companies run”, as Mr Ghosn likes to say.

The architect of the Nissan deal was Louis Schweitzer, the chairman and chief executive of Renault. Mr Schweitzer had been running the rule over Nissan since the mid-1990s when he became concerned, after Renault's part-privatisation, that it was too dependent on France and western Europe. Part of the attraction of Nissan, he says, is that “it gave us entry into Japan and the United States”: Renault had twice before had to beat a retreat from America. Mr Schweitzer had always thought there was a 90% chance that the deal would work, otherwise he would not have risked investing $5 billion (half Renault's equity) in ailing Nissan. But many thought him crazy.

After the stockmarket crash in Asia, Renault felt that it could at last afford to acquire control of Nissan without bankrupting itself: Renault's market capitalisation on its way up overtook Nissan's on its way down. A letter to Nissan's boss in January 1998 was well received. What Mr Schweitzer did not know at the time was that Nissan had approached both Daimler-Benz and Ford for a rescue, but both of them had shied away.

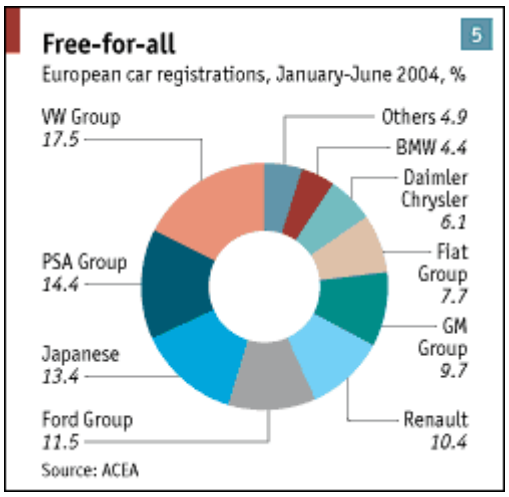
Now Renault and Nissan are pushing ahead with their plans to share car platforms, reducing the number across the two companies from 40 in 2000 to ten in 2010. This will open the way to common purchasing which Commerzbank analysts reckon will save them more than €500m a year. On top of such operational savings, Renault will this year derive about a fifth of its profits from Nissan dividends.

For much of the past decade, the two surprising stars of the European volume car market have been Peugeot and Volkswagen. Peugeot delivered outstanding shareholder returns by keeping a tightly focused range of products, refreshing them often and refusing to spend too heavily on new capacity. Instead, in keeping with its stern Protestant roots in south-eastern France, it sweated its assets and ruthlessly pushed through changes in working practices to achieve more flexibility. It also benefits from using the same components to produce two complementary brands with very different customer appeal. Other assets include its excellence in diesel engines for small cars and its joint ventures for engines, small vans and small cars with partners that include Ford, Fiat and Toyota, with which it shares a factory making a cheap car in the Czech Republic.

Volkswagen's profits are falling fast, but it is tackling its high costs. Its big challenge is to show that it can manage its sprawling stable of brands, ranging from Bentley and Lamborghini to Audi, SEAT, Skoda and VW itself. To introduce more coherence, its boss, Bernd Pischetsrieder, appointed Stefan Jacobi as director of marketing for the whole VW group to ensure that none of the brands got in each other's way.

Europe's three weak brethren are Fiat, Ford Europe and GM Europe. Fiat seems to many observers to be in terminal decline, not least because of the frequent changes in its top management and the refusal so far of GM, which bought a 20% share in the Italian company four years ago, to take up its share of a recapitalisation last year. Its stake in Fiat Auto is now down to 10%. But the present head of Fiat Auto, Herbert Demel, is pressing ahead with a rescue plan drawn up with the banks, and the company has had a hit with its new Panda small car. Fiat was nearly sold to DaimlerChrysler in 1999, but Gianni Agnelli, the patriarch of the controlling family, could not bear to lose it. An earlier attempt to hook up with BMW had fallen at the same hurdle.

Ford and GM used to mint money in Europe when local companies such as Renault, Peugeot and Volkswagen were not doing very well and imports from Japan were restricted. But since 1984 Nissan, Toyota and Honda have been opening their own European factories and the competition has grown tougher. Toyota alone now has 5% of the European market. In the past decade Ford and GM have lost billions in Europe. Last spring GM's boss, Rick Wagoner, asked his number two, Bob Lutz, to sort out the company's European operations. Within three months Mr Lutz, a Swiss-born American who once ran Ford Europe, had created an integrated structure to bring together GM's three previously disparate European businesses, Adam Opel in Germany, Vauxhall in Britain and Saab in Sweden. Fritz Henderson, a former boss of GM Latin America and GM Asia Pacific and, at 45, a rising star in the company, has been charged with putting Mr Lutz's plan into effect. In June he became head of GM Europe in Zurich.



What a difference a decade makes

Ten years ago Europe's car industry was struggling. Its premium marques, Mercedes and BMW, had yet to emerge as strong global brands. Volkswagen was dragged down by the acquisition of a Spanish firm, Seat, and by its high production costs in Germany. Renault's attempted merger with Volvo had fallen apart after the Swedes resisted French government dominance. Little PSA Peugeot Citroën seemed too small and too restricted to Europe to survive.

Now BMW and Mercedes have broken through in global markets, and Volkswagen has grappled with many of its problems and made progress in America and in China. Peugeot has done rather well and is no longer so heavily dependent on France. Renault has changed the industry's entire landscape with the Nissan deal. With the exception of Fiat, the European industry is in surprisingly good fettle. Even Daimler-Benz's ambitious transatlantic leap to join with Chrysler is at last beginning to show signs of working. That leaves only Fiat still stuck with losses.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Here be dragons

Sep 2nd 2004
From The Economist print edition

China will be a much tougher market than many people think

NO WONDER car companies are excited about China. Car sales there have been growing by leaps and bounds for a decade, in some years by as much as 50%. This year the Chinese market has overtaken the German one as sales surge towards 5m; in three years it could be bigger than Japan's. All the big western car companies have joint ventures with local ones, such as Dongfeng and Shanghai Automotive Industry Corp (SAIC). Their net profit margins in China average more than 9%, compared with barely 2% in America. Volkswagen and General Motors, the market leaders, make a third and a quarter respectively of their global net profit there, according to a new study by AlixPartners, a consultancy.

But the milk and honey could soon dry up as capacity outruns demand. A huge wave of new investment is now going into Chinese car plants. According to Automotive Resources Asia, a consultancy in Beijing, western car firms are set to invest about $13 billion over the next five years. This summer GM announced plans to spend $3 billion to double its capacity in China to 1.3m vehicles a year; Ford said it would invest $1.3 billion, and VW about $6 billion.

This reminds many of Brazil's car-investment boom a decade ago that ended in a spectacular bust. Things in China are unlikely to get as bad as that, but capacity utilisation is low in many plants, making for dreadful operating economics, and demand, although still soaring, cannot keep up with the new investment. Capacity last year reached 3.4m cars , say consultants at PricewaterhouseCoopers, and is due to rise to 5.5m within a few years.

Over the past three years prices have already fallen by about 25%, and experts expect the decline to continue at the rate of around 10% a year as competition hots up. Booming developing markets and overcapacity often go together as all the makers rush to join the game. They see losses in the early years of a factory's life as normal, but hope to reap profits later.

Aside from foreign carmakers, China also has over 100 home-grown car companies, which usually copy western designs with scant regard for intellectual property rights. Chery, for example, has been very successful with its little QQ model, a clone of GM's Chevrolet Spark. At $5,000, it is $1,250 cheaper than the Spark, and outsells it by about six to one.

GM's complaint to the government in Beijing will probably drag on for a few years as Chery, with the help of western experts, develops its own models. In the meantime, people like GM's Mr Lutz expect to see small Chinese cars being exported to America. So not only will China be a tougher place for westerners to continue to make fat profits, but it will become a serious competitor in Asian markets and even in America and Europe.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Fighting back

Sep 2nd 2004
From The Economist print edition

What carmakers are doing to counter relentless competition

FOR the past 20 years, carmakers round the world have been trying to emulate Japanese companies' success in lean manufacturing, seen as the benchmark for ensuring quality and efficiency, especially as practised by Toyota. Most car factories have now been revamped more or less along Japanese lines, so the gap between Japanese and western producers has become much smaller. Indeed, four of the five most efficient assembly plants in North America belong to GM.

Glenn Mercer, head of automotive services at McKinsey, a consultancy, explains that once all the makers have got the labour content of assembling a car down to 18-20 man-hours, lean production becomes less of an issue. “Manufacturing is not the game now,” he says. But differences at the margin still count. GM is ahead of Ford on productivity, giving it lower variable costs and enabling it to offer larger discounts to hold on to market share. The next thing everyone has to do is to make factories more flexible so that they produce what customers want and what is selling well. The idea is to tie product development, marketing and manufacturing more closely together.

The main thrust of competition at the moment is in product development. Each company is trying to compete in every segment of the market, with a plethora of niche models designed to attract particular groups of consumers, and to renew them rapidly enough to keep interest fresh. This is causing the market to fragment. The days are over, says Richard Parry-Jones, boss of product development at Ford, when you could get 30% of the European mid-sized market (which means 10% of the total market) with just one bestselling Ford Cortina four-door family saloon. “Nowadays you would need five or six derivatives, including a five-door, a station wagon, an MPV (the European name for compact minivans) and an SUV.” Likewise, whereas a decade ago Ford in America could count on selling 750,000 of its F-150 pick-up trucks a year, now it has to have umpteen variations to hit that level.

Twenty years ago, Americans had a choice of several different classes of saloon cars or station wagons, offering a range of prices, features and sophistication. At the top end were big, quiet luxury saloons such as Ford's Lincoln Town Car or GM's Cadillac DeVille. At the bottom were little Ford Escorts and Chevrolet Cavaliers. In-between were big but basic models. Now about one in two vehicles sold in America is a pick-up, an SUV or a minivan. In addition there are so-called crossover vehicles, big SUVs such as the Cadillac Escalade or the Ford Excursion, which offer the ride and comfortable interior once found only in luxury cars. Throughout the whole range there are niche models that combine sporty features—for instance, for driving off-road or towing power-boats—with more general utility.

In Europe and Japan, the main difference between cars has traditionally been size. Small cars were usually basic; medium-sized cars, epitomised by the ubiquitous Ford Cortina, a little less so. Now even the small cars have fancy fittings such as electric windows and air conditioning, and there are whole new

categories of niche vehicles, such as Fiat's cheap-and-cheerful new Panda and the ultra-cheap new Renault Logan.

The cost of fragmentation

In their book, “Time for a Model Change”, Messrs Maxton and Wormald say that this proliferation of models and variations is making the business too complex and too expensive. They have calculated that the number of combinations of style and fittings in some vehicles runs into billions. But others are more sanguine about the larger range of models. David Cole, chairman of the Centre for Automotive Research (CAR) in Ann Arbor, Michigan, thinks the business has become less risky now that engineers are able to use computers to speed up the development of new models and variations. New cars can be designed and viewed on screen rather than laboriously designed bit by bit, then demonstrated in a clay model to show what the finished product will look like. That is just as well, because the pace of competition has speeded up too.

Bob Lutz at GM reckons it takes about 36 months to get a new vehicle into the showrooms. The first 12 months go on figuring out what sort of vehicle it should be and making the business case for it, and the next 24 months are spent working on the design and engineering. In Europe, car models used to be designed to last for seven years, with perhaps one facelift after a few years, but now the trend is towards the American pattern of updating models every year. European makers such as Fiat, Peugeot and Renault have seen their sales and market share slump at different times as the average age of their models grew.

Both PSA Peugeot Citroën's boss, Jean-Martin Folz, and his Renault counterpart, Louis Schweitzer, are determined to keep the average age of their models below three years. The trick, says Mr Schweitzer, is to do that without investing too much in tooling up for makeovers. The example everyone wants to avoid is Ford in Europe. Starting in the mid-1990s, it began to neglect product development to save money, allowing the average age of its models to creep up towards five years. The market share of Ford-badged cars slumped from 12% to barely 8%, from which the company is finding it almost impossible to recover.

Japan is quite different. Car buyers there are interested only in completely new models, not facelifts. But then the country has hardly any second-hand car market because rigorous technical checks cause vehicles to be scrapped within five years. This is akin to a permanent government stimulus to demand for new cars, of the sort the French, Italian and Spanish governments introduced in the 1990s. They offered incentives to drivers to scrap their old cars if they bought new ones, in the hope of boosting Fiat, Renault and so on. Something similar happens in America, except that it is the shareholders of the Big Three who bear the costs.

Your wish is our command

Given the huge range of models that car companies must offer now, they have found they need factories that are completely flexible, able to switch from making one model to another to meet fluctuating demand. Honda was first to latch on to this, organising its global spread of factories so that any one of them could make any car, with only short delays for rearranging the machinery. More recently others, such as Ford in Europe, have re-vamped their facilities with the same end in mind. Even in its heartland, the River Rouge factory beside Ford's head office in the Dearborn suburb of Detroit, Ford is replacing an old plant with a new, more versatile one. This will make SUVs and other light-truck vehicles, working with three different vehicle platforms (the basic floor and underpinnings of a car) to produce a mix of nine different models.

For some years now, manufacturers have used common platforms to serve as the basis for a whole range of models, aiming to widen their range without wholesale redesigning, engineering and tooling-up. Models that share the same basic architecture can be welded and assembled on the same lines by the same robots. Platform-sharing was carried furthest by Volkswagen under its former chief executive, Ferdinand Piëch. But his successor, Mr Pischetsrieder, quickly concluded that the process had gone too far.

Thus, sales of the Czech-built Skoda (which was bought by VW in the early 1990s and had its cheap-and-nasty image burnished by its new owner) were challenging the posher German-made Golf, which used the same platform. Now VW is concentrating on what it calls “modules”: different models still share parts, but not to the extent that different brands end up looking the same. Ford is going the same way, says Mr Parry-Jones. “The trick is not to commonise the wrong bits in different models. You commonise

parts such as batteries and alternators, not things the customer can see, like the window switches."

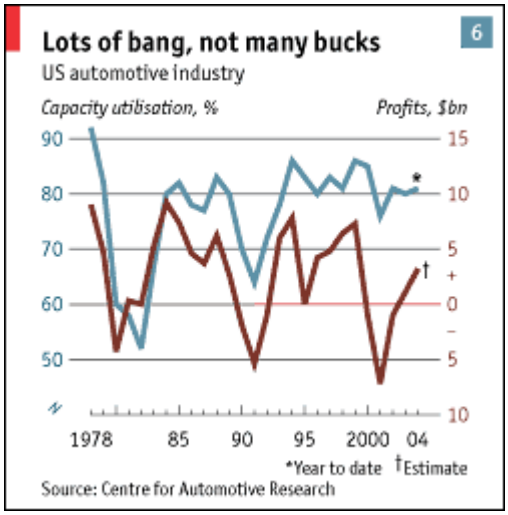
Another way of saving money on making cars, design for manufacture, played a big part in the last rescue of pre-DaimlerChrysler in the early 1990s, though it has faded somewhat in the past ten years. In addition to having a smart range of best-selling Jeeps and minivans, the company brought out a line of cars that had been specifically designed for simpler, cheaper manufacture, without detracting from their qualities. Even Toyota was impressed when it pulled apart a little Chrysler Neon ten years ago by how well it had been designed for economical manufacture.

But with every manufacturer trying to outdo the others with a proliferation of models, and having to slash prices to shift its stocks of finished cars, a more radical approach may be needed. Instead of guessing in advance which models and which variants are going to sell, why not build to order?

For years, companies such as Renault and Fiat have been trying to cut the time that elapses between a customer placing an order for a car and taking delivery. Much of this is taken up with paperwork before the order is allocated to a particular factory. Renault has recently given up on its aim of reducing the time from order to delivery to 14 days, settling instead for 21.

There is a glaring paradox in the way cars are produced. Manufacturers sweat blood, and squeeze their suppliers hard, to operate a just-in-time production system whereby the components for each car arrive at the right place on the assembly line at precise intervals several times a day. Given that the average car is made up of about 10,000 parts, some of them produced thousands of miles away, this is a miracle of logistics.

Yet once the car is finished, it usually sits around for 40-80 days, parked in fields, distribution centres and forecourts. So just when all those parts have been put together to make them more than the sum of their value, they are left lying around for months—a huge pile of profit-eating inventory. Moreover, most of these vehicles need to be discounted to get people to buy them, because customers rarely find the exact combination of colour, trim and options they are looking for.



This is the part of the carmaking system that lean techniques cannot reach. It mattered less in the days when dealers (particularly in America, where customers like to walk into a showroom and drive off in their purchase) could get the sticker price for their cars. But now some think the whole system is close to breaking point.

Mr Cole of CAR, one of America's most respected analysts of the industry, suggests that its current business model is already broken. He points out that in the good old days car firms would make a profit as soon as their factories were operating at more than 80% of capacity; the cash dried up when plant utilisation fell to around 50-60%. These days utilisation is consistently high, but for the wrong reason: discounts. So even when the factories are busy, there is no guarantee of profits.

Reversing Fordism

The magic answer to all this, some say, is "build to order" (BTO). Various working groups in the industry have been studying the feasibility of what is often called the "three-day car", quickly assembled to the customer's actual orders, rather than to the forecasts made by the sales department. The theoretical gains by applying lean techniques in this way are large: Nissan has calculated they could be as much as $3,600 a vehicle. Consultants from McKinsey reckon that eliminating stock losses (from unsold cars having to be financed) and the associated discounts needed to clear them could be worth a fabulous $80 billion a year to the world's car manufacturers. But this looks suspiciously like a crock of gold at the end of some global rainbow.

Everyone agrees that manufacturers could do much more to ensure that customers get their car in the colour they want, with the options they want, when they want. The shorter the order-to-delivery cycle, the lower the costs of carrying stocks of finished cars. But that still leaves the problem of smoothing production at the factory to preserve the economies of scale, which even in modern scaled-down plants

require a throughput of about 250,000 cars a year.

However, in a recent book, “The Second Century: Reconnecting Customer and Value Chain Through Build-to-Order”, two academics, Matthias Holweg and Frits K. Pil, dismiss such fears. They point out that even conventional “build to forecast” production involves wide swings in capacity utilisation, partly because there is a seasonal pattern to buying cars. Broadly speaking, more cars are sold in summer than in winter. Demand can also slump in response to interest-rate rises. Manufacturers, the authors suggest, could deal with the ebbs and flows of demand by offering lower prices for later delivery, in the same way that airlines offer discounts on early bookings. Carmakers could also use purchases by employees, which often account for as much as a quarter of a car company's output, to lop off peaks and fill up troughs.

But, asks Mr Mercer, what happens if there is a lot of snow in January? “Do you shut the factory because no one is coming to dealers to order cars?” In fact, BTO could face problems in America, where buyers look for instant gratification by getting the best deal for the car on the forecourt that most closely matches their wishes. The more the model strays from what they want, the bigger the discount they seek. The deal is everything.

One thing that could start to change those habits is the increasing use of the internet, where many intending car buyers go to window shop and to compare prices and options. Some internet enthusiasts claim that seven out of ten car buyers go online as part of the process.

The place where BTO comes into its own is Germany, the home of premium cars such as BMW. The Munich manufacturer already builds about six out of ten cars to order, but there is less to this than meets the eye. For a start, the order-to-delivery time is very long, up to two months, much longer than customers for true mass-market cars would be prepared to wait. Germans are happy to accept such delays in getting hold of their BMW or Mercedes because they assume that a lot of care has gone into making the car. But this is hogwash: it takes no longer to make a BMW than to make a Ford, less than two days in the body shop and assembly plant.

What takes the extra time is the consolidation of orders via dealers, the loading schedule for the factory and delivery, and the checks on the finished product. But this works only if you are making highly desirable cars that people are happy to wait for. BMW is also able to smooth production by pushing through thousands of cars destined for the American market if there are lulls in European orders.

A low-cost entrant

So what else can car companies do to make themselves even more competitive? One interesting idea has recently surfaced from a team led by Steve Young at A.T. Kearney, a consulting firm, working with Martin Leach, a former president of Ford Europe and the product-development wizard behind the revival of Ford's Mazda associate. The team set out to design a “new generation” car company, a bit like the new low-cost budget airlines now spreading everywhere.

What they came up with was a “virtual” company that would outsource just about everything, from organising networks of suppliers to manufacturing, some design and delivery, and service. Manufacturing would be done in small plants within each national market, to ensure that it was close to the customers. Parts would be made in a network of factories in low-wage countries, a rigorous extension of what is already happening in the industry today.

Such a company, the team found, would have an operating margin of about 22%, roughly double that achieved by Nissan, the best of the conventional volume carmakers in 2002. That would make its returns nearly three times better than Toyota and BMW; four times better than Peugeot and DaimlerChrysler; and more than 20 times better than GM and Ford.

The secret behind this high return is that such a company would be offering services throughout the whole automotive supply chain. It would sell mobility, not cars. At the moment, explains Mr Young, the car companies win revenues (and profits) only from the start of the life of a car. But if they leased the car and retained ownership throughout its entire life on the road, typically eight years, they could tie in revenues from such things as insurance, servicing and repairs.

Their putative company, which they dubbed Indego, would make four models and aim to sell a quarter of a million of each. But because the company would be leasing the cars several times over as used vehicles and providing associated services, such as insurance, 250,000 vehicles going through several

transactions over eight years could generate the same sort of revenue as a conventional car company making 2m vehicles a year. Moreover, the product-development costs would have been written off against eight times the volume of eventual revenues. Mr Young says that the exercise has been well received by many manufacturers, particularly components firms, which are trying to introduce elements of his model into their operations.

If distributed manufacturing and the virtual car company sound somewhat familiar, it is because elements of them have been mooted before. About six years ago, Peter Wells and Paul Nieuwenhuis of Cardiff Business School launched the idea of micro-factories assembling low volumes of cars within local markets; their micro-factories would also act as retail distribution points.

Indego seems to have been inspired by other pioneers too. In 2000 Jacques Nasser, then boss of Ford, tried to turn his company into an all-singing, all-dancing consumer outfit providing automotive services. In many ways he was ahead of his time. But Ford, and Mr Nasser's career, came to grief because his grand strategy involved too many initiatives and too much expensive diversification downstream. When the company had to replace millions of defective Firestone tyres fitted to its SUVs, the audacious experiment suddenly stopped. That may have set back much-needed changes in the way the car industry is organised by a generation.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Clean machine

Sep 2nd 2004
From The Economist print edition

The car of the future will be bristling with electronics, and may be run by electricity

THE two big changes in cars themselves over the next ten years will be in electronics and engines. Electronics are taking over more and more of a car's controls, and are now making it possible to connect cars as well as drivers with the outside world. It is only a matter of time before the industry switches from 12-volt batteries to 42-volt ones to meet the extra power demands of all this equipment.

At the same time demands for yet more reductions in tailpipe emissions of carbon dioxide and noxious gases such as carbon monoxide and nitrogen oxides are causing changes under the bonnet. With Hollywood stars such as Harrison Ford and Cameron Diaz thinking it cool to arrive at Oscar ceremonies in their little hybrid electric Toyotas, alternative fuels are firmly on the consumer as well as the regulatory agenda. Toyota has handed out free Priuses to the glitterati to get attention.

But for the moment the action is electronic rather than electrical. Telematics, which connects computers and other electronic devices by radio, has been under discussion for a long time, but has been slower than predicted to take off. At the Detroit motor show in 2000, with the dotcom bubble still fresh in people's minds, pride of place on Ford's stand went to a very plain, cube-shaped car called the 24:7. It looked like a small child's drawing of a car, a box with a wheel at each corner. The dashboard had a computer screen, and the driver was meant to log on to “his” or “her” car. The vehicle could be programmed to perform differently for different users, and its software would adapt the communications devices to each user's needs. It was connected to the internet, so if you were stuck in a traffic jam you could use the time to check your e-mails or browse the web.

It was wired, weird and typical of the times. Now carmakers have gone back to talking about design, speed, handling, ride and comfort. Yet electronics in cars are becoming more important in all kinds of ways. For example, electronic circuits determine the optimum fuel/air mixture, ignition sequence and valve timing on a modern engine 6,000 times a minute. Without that kind of technology, there would have been none of the dramatic improvements in cars' fuel economy over the past 20 years.

Electronic devices also decide within microseconds of a crash how to inflate the airbags. Modern cars have about 80 such electronic control units, in effect tiny computers, with software running to 1m lines of code; electronics are replacing mechanical parts as the nervous system of the modern car. Its ride and handling characteristics can be changed simply by altering the software settings for the steering, suspension and brakes.

The use of telematics takes all this a giant step forward. Telematics connects cars with the outside world and with each other. Early experiments such as the automated highway in California on which electronically linked cars were whizzing along while the drivers dozed off or read the paper will probably never lead anywhere. But the growing use of on-board electronic devices monitoring the car's mechanical systems, and the arrival of digital radio (which is better at transmitting electronic signals), look set to produce real benefits. Unbeknown to drivers, systems built into cars already record, for instance, when and where airbags inflate; this information is used after a crash to find out exactly what happened.

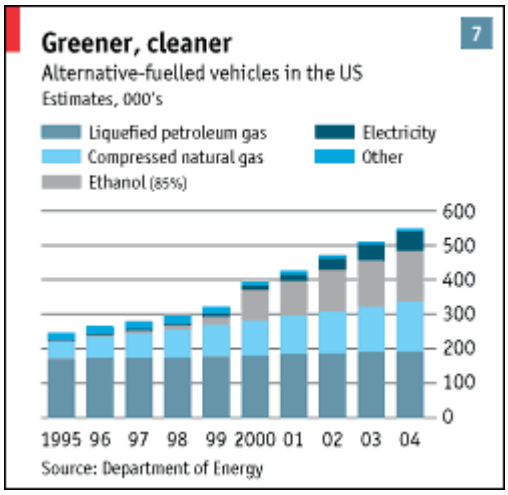
Some analysts say that within three years there will be telematics devices in two out of every three new vehicles in America, compared with only one in 20 in 2000. Over the same period the number of users of satellite navigation systems is expected to rise from 1m to 30m.

The age of telematics

Currently the industry is debating three main telematics applications for cars. The so-called front-seat market covers safety and security devices, including traffic reports and route-mapping via satellite

navigation displays, and automatic connection to emergency services in the event of an accident. That means the paramedics will know how to find a crashed vehicle even if the occupants are in no state to tell them where to look.

The “back-seat” market promises on-demand digital movies and interactive games. The third application is the transmission of technical information from computers monitoring the car's mechanical parts direct to the manufacturer or dealer. This makes it possible to diagnose faults remotely and even predict the impending failure of parts of the car. Some enthusiasts also forecast voice-activated internet connection without a mouse or keyboard, but tightening rules against driver distractions may stop this before it gets going. Another obstacle to the spread of on-board devices may be the availability of hand-held ones, in the same way that carphones have largely given way to mobile phones.



One sector where telematics is already making a huge impact is commercial traffic. For all sorts of security, safety and operational reasons, freight companies find it invaluable to know where their lorries are and what they are doing at any one time. On-board GPS systems make this possible. In Britain, such a system is being introduced as part of a road-pricing scheme for lorries on some motorways.

Telematics could also help to make cars safer. The American government's road-safety body has calculated that lane drift on motorways is responsible for 43% of all fatal accidents on highways there. Telematics devices now being installed in luxury models tell the driver when he strays sideways or gets too close to another vehicle. If these were widely adopted, they could help to make driving much safer. Some cars now have a form of cruise control that stops the vehicle colliding with another. Fiat has even demonstrated a “driverless” car that can spot and steer round obstacles on a test track.

The next phase will involve electronics taking over from mechanical controls on vehicles. A combination of electronics and pneumatic power could be used to open and shut the valves on each cylinder of an engine, eliminating the complex mechanical valve drives of today. Steering and braking could also be controlled electronically and operated by tiny electric motors, in theory at least, so cutting the need for heavy metal brakes and pedals. Transmissions could become entirely electronic. After all, aircraft have been “flying by wire” for 20 years, so it should not prove impossible to convert mere motor cars.

But for the moment, such gee-whizz electronics applications could be marred by a problem familiar to every PC user. Luxury-car owners can find that their fancy new Mercedes or BMW suddenly goes awry because of a software glitch. And there are now so many electronic devices built into cars that manufacturers are having to install sophisticated electronics networks to integrate them. An executive at one parts company says that electronics in a car are seven times more likely to fail than mechanical parts. No wonder the manufacturers are now working together to draw up common software standards. According to an apocryphal industry story, Microsoft's Bill Gates once quipped that if GM had kept up with technology as the computer industry had, people would be driving around in $25 cars. To which one GM wag replied, “Would you want your car to crash twice a day?”

Hybrid solution

After 40 years when environmentalists' main grouse about cars was the damage their emissions of nitrogen oxides caused to local air quality, the emphasis has now switched to carbon dioxide, which is thought to contribute heavily to global warming. A few years ago the European Commission persuaded carmakers in Europe to agree to a voluntary deal to cut overall emissions across their car fleet by 25% by 2008, or face the imposition of strict emission rules for specific models. This summer California drafted regulations requiring car manufacturers to reduce emissions of carbon dioxide by 30%, starting in 2009.

The manufacturers are likely to challenge this in court. They point out that carbon dioxide itself is not toxic, and a state has no right to apply what are in effect fuel-economy rules, the prerogative of federal government. But California's governor, Arnold Schwarzenegger, has already expressed his support for the legislation behind the carbon-dioxide rules.

California already has regulations that will require at least 10% of a car company's fleet to be “zero emissions” vehicles (ZEVs) from the start of next year if the company wants to continue to sell in the state. California accounts for a tenth of America's car market, so its state government's environmental policies are taken seriously. After some concessions on the timing of the ZEV ruling, Ford and Chrysler dropped court actions to block the rules, and now every manufacturer is scurrying to get a ZEV ready in time.

The only conceivable ZEV is a car powered by an electric motor that runs on a fuel cell. A fuel cell combines hydrogen with oxygen from the air to produce water. The process generates an electrical current strong enough to power a car. Honda was the first to get a ZEV ready for the market, but nearly all the other car companies are working on their own versions. GM recently drove a fuel-cell minivan from the Arctic Circle to Portugal to test the robustness of the system. But fuel cells are still about ten times more expensive to make than internal-combustion engines, and cost, technical and safety problems remain to be resolved in setting up a distribution system to get hydrogen into the cars.

Meanwhile most car companies are introducing hybrid-electric cars, emulating Toyota's Prius, of which 200,000 have already been sold. Hybrids hook a small petrol or diesel engine to an electric motor and a storage battery. The electric motor runs the car in slow and stop-start motoring and the conventional engine cuts in on the open road. The battery also provides extra power for acceleration. It is kept charged by the conventional engine and by the energy generated during braking.

Quantum leap

In theory, once all the bugs have been sorted out fuel cells should deliver better total fuel economy than any existing engines. Allowing for the resources needed to extract hydrogen from hydrocarbon, oil, coal or gas, the fuel cell has an efficiency of 30%. That is twice as good as the internal-combustion engine, but only five percentage points better than a diesel hybrid.

But once hydrogen is being produced from biomass or extracted from underground coal or made from water, using nuclear or renewable electricity, the way will be open for a huge reduction in carbon emissions through the whole system. Experts such as Larry Burns, head of research at GM, reckon that only such a full-hearted leap will allow the world to cope with the mass motorisation that will one day come to China and India.

In the meantime, given the questions still to be resolved on fuel cells, hybrids are widely seen as the best way of cutting carbon dioxide and other emissions for the next 20 years. Another interim solution, according to Gerhard Schmidt, Ford's head of research, could be burning hydrogen in internal-combustion engines; this is less efficient than using it in fuel cells, but would ease the transition to hydrogen fuel cells in due course, allowing time to build a hydrogen distribution system. One way or another, electricity is changing cars.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Driving change

Sep 2nd 2004
From The Economist print edition

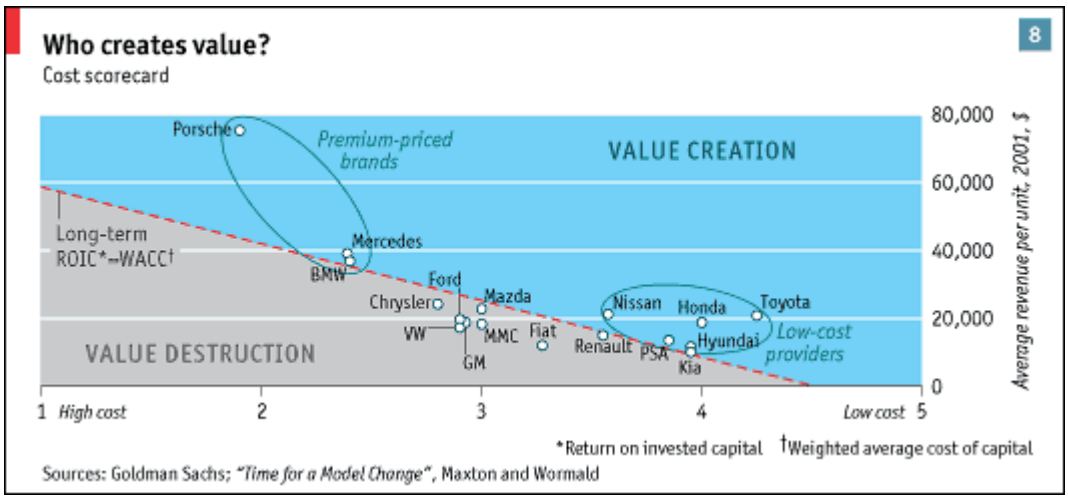
Technological change could help reform the car industry

IT IS easy to see why the motor car and the motor industry became symbols of 20th-century consumer capitalism. Cars are an expression of personal freedom, to go where you want, when you want, without having to follow the herd or abide by someone else's timetable. Congestion may have narrowed that freedom, but it remains part of the lure of the automobile. The French philosopher Roland Barthes, writing about the 1950s Citroën DS, compared cars to great Gothic cathedrals. "I mean the supreme creation of an era, conceived with passion by unknown artists, and consumed in image if not in usage by a whole population which appropriates them as a purely magical object."

The magic faded a little when the oil-price rises and safety regulations of the 1970s turned most cars into drab front-wheel-drive boxes that all looked much the same. But for the past ten years the design flair of older generations has been creeping back. GM's new Cadillacs, Nissan's new 350Z car (a retro nod to a 1960s model), and Renault's bustle-backed Mégane, Scenic and Vel Satis are recent examples. Even BMW, long famous for severe, classic straight lines, has recently gone curvy (too curvy for some of its traditional customers). Cars are becoming sexy again.

The car may be the ultimate consumer good in a consumer age, but it is also increasingly a product of fashion as well as engineering, with design once again becoming crucial to brands. And brands have become far more important in recent years, in cars as in other consumer businesses. Appropriately enough for a nation famous for fashion, France, with its Renault and Peugeot brands, was among the first to put the designers back in the driving seat in the mid-1990s. Now all manufacturers are seeking a family look across their whole range so that people can identify their cars at 50 paces. Successful car designers appear at motor shows to introduce their latest models, like couturiers showing off their new collection.

But why is this pillar of capitalism not more successful at consistently delivering the ultimate reward of capitalist enterprises, fat profits? A recent analysis of the financial performance of all the leading car companies by Goldman Sachs, an investment bank, came to a sobering conclusion: out of the world's top 17 car companies, only half were earning more than the cost of their capital (see chart 8). The value creators in Europe were Porsche, the Mercedes bit of DaimlerChrysler, BMW and Peugeot. In Asia, Toyota, Nissan, Honda, Hyundai and Kia made the cut. But America's Big Three, GM, Ford and Chrysler, were all in the value-destruction group, along with Renault, Fiat, Mazda, Mitsubishi and VW.



The overriding reason for the lack of profits is excess capacity in mature markets. Under normal market conditions such a surplus would be competed away, but that rarely happens with cars. Manufacturers

hold on to their capacity, grimly hoping that the next model will win business away from the competition and fill their coffers. They provide jobs, pensions and health care for their workers, who in turn buy a quarter of the cars produced. No wonder GM has been called a workers' collective, and Detroit a mini-Sweden.

Imperfect competition

One plausible explanation of this aberrant behaviour lies in the industry's ownership structure. Families play a big part in Ford, Fiat, BMW and Peugeot. Where there is no family, it may be corporate giants propping up the industry. Without the approval of Deutsche Bank, Jürgen Schrempp would not have survived the decline in DaimlerChrysler's value since the merger. More importantly, there is often government involvement of one kind or another. Renault and Volkswagen, for instance, remain in partial public ownership, whereas the British and French governments throw money at their Japanese-owned car factories at the mere suggestion that a new model might be made elsewhere. And America's states have been offering incentives to lure foreign car companies ever since Honda opened the first American transplant factory nearly 22 years ago.

GM's boss, Rick Wagoner, regularly complains that the Japanese government is providing indirect aid to the country's car companies by holding down the yen, thereby lowering their costs of producing export models and parts for their American assembly plants. GM economists reckon that this currency-market intervention amounts to a subsidy of $2,500 for every Toyota sold in America, and $12,500 for an upmarket Lexus. American manufacturers, and not just those in the car industry, maintain that the Japanese do this solely to boost their exporters, but they are overstating their case: the main purpose of the policy has been to head off deflation and revive the domestic economy.

Allowing for all these powerful outside influences on the industry, most car firms will try to muddle through. There is little enthusiasm for further consolidation: the example of Daimler's troubles with Chrysler is enough to put anyone off. Fiat is widely seen as the company closest to the brink, but the Italian government is unlikely to let it die outright. As McKinsey's Mr Mercer puts it, “No politician wants to stand in front of a closed car factory.” Over a longer period, though, once-mighty companies can wither away. In the mid-1970s British Leyland was the world's third-biggest car firm, but now it has all but gone, its brighter brands long sold off.

The only sort of consolidation that seems likely is the defensive sort that might come from distressed companies selling off assets. In their book, Messrs Maxton and Wormald suggest that a troubled Ford might be forced to sell Land Rover, Jaguar or Volvo. But these fine brands make hardly any money: among Ford's premium brands, only Volvo has been trading profitably in recent years, and Jaguar is reckoned to have swallowed $6 billion of Ford's money in the 15 years since it was acquired by the American giant. Even after much management attention, its current business plan is still not working, with sales around 120,000 a year instead of the hoped-for 200,000.

If GM felt financially desperate, it could generate some cash by selling its stakes in Suzuki or Subaru. But that would be a complete reversal of the firm's strategy, of building a network of global alliances to enter distant markets and share the development costs of small cars specially designed for them.

The car industry's long-standing obsession with scale arose from the needs of its manufacturing processes. Garel Rhys, director of the Centre for Automotive Industry Research at Cardiff University, has calculated that economies of scale reach their peak at 250,000 cars a year in an assembly plant, although for the body panels the figure could be as high as 2m. This goes back to the invention of Buddism in the 1920s. Budd's pressed-steel monocoque body shells could be made only by huge, expensive press tools that needed vast production runs to repay the investment. If cars were still built with a chassis and a separate body, like Henry Ford's Model T, the industry might look very different.

Some of the alternative business models currently being touted would, in effect, attempt another revolution, with companies outsourcing more and more of the car. Some even envisage the return of the steel frame with pre-painted body panels hung on it, as used for the runabouts produced by Mercedes's Smart division. Fiat and Audi, too, have turned to alternative manufacturing methods, using what is known as space-frame construction rather than pressed panels for giving the vehicle strength. The body panels are riveted on to the frames in a way that Henry Ford would recognise immediately. This method is particularly attractive for production runs of less than 100,000 a year, obviating the need for large numbers of huge presses to stamp out expensive floorpans. Space-frame technology can also be easily adapted to make cars wider, longer or taller, which brings other benefits.

If consumers are demanding an ever wider choice of vehicles, it follows in a mature market that production runs have to get smaller. Car companies are already reconciling themselves to this trend. That increases the appeal of more flexible manufacturing methods. Many car companies are quietly developing expertise in this new way of making cars but are reluctant to talk about it. GM caused anxiety among its unionised workforce a few years ago when it talked publicly about its Project Yellowstone, to adapt production by assembling cars from pre-prepared modules made by outside parts suppliers.

Changes to manufacturing methods could also arise from new technology being incorporated in cars, particularly as less polluting alternatives to petrol and diesel engines come along. Over the next 20 years, the market share of petrol and diesel hybrids and fuel-cell electric vehicles will probably rise to about 10%. Even an arch-petrol-head like Mr Lutz has been convinced by the progress made with these technologies in the past two years. “But I don't say they'll be fun,” he quips, “Better keep a motorbike on the side.” Much of the heavy cast metal in cars will also go as drive-by-wire becomes standard and heavy metal modules such as steering and brakes are jettisoned.

As the industry's products begin to change, so will the way they are made. In time, there will be less need for huge, capital-intensive factories, so the barriers to entry will come down. Start-up companies could take business away from established traditional manufacturers. Low-cost carmakers could swoop in, rather as low-cost airlines have done in aviation.

The conventional wisdom in the car industry is that it will continue in much the same shape as at present, with today's six big companies dominating global markets, even though half of them fail to earn a wealth-creating return on capital. Car companies, says McKinsey's Mr Mercer, are like steel mills and airlines, often seeming to teeter on the edge of bankruptcy but somehow managing to keep going. But such long-established industries are already being shaken up by newcomers.

In carmaking, those newcomers could be parts manufacturers moving into assembly, or outside companies taking advantage of the shift to new technology. As cars are increasingly powered by fuel-cell electric engines and fitted with drive-by-wire electronics, new entrants with skills in these areas might start to offer their own models. And even before that happens in a decade or two, new competition of a more conventional kind is bound to come from Chinese manufacturers selling low-price cars in Asia and America.

The old car firms must reinvent themselves to seek profit, not just market share. Otherwise new, nimbler competitors will take advantage of technological change to do the job for them.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com RESEARCH TOOLS SURVEYS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Sources

Sep 2nd 2004
From The Economist print edition

"The Second Century: Reconnecting Customers and Value Chain Through Build-to-Order", by Matthias Holweg and Frits K. Pil, MIT Press, 2004.

"Time for a Model Change: Re-engineering the Global Automotive Industry", by Graeme Maxton and John Wormald, Cambridge University Press, October 2004.

"The End of Detroit: How the Big Three Lost Their Grip on the American Car Market", by Micheline Maynard, Doubleday, 2003.

"Comeback: The Fall and Rise of the American Automobile Industry", by Paul Ingrassia and Joseph B. White, Simon & Shuster, 1994.

"The Automotive Industry: A Guide", by P.E. Wells and P Nieuwenhuis, Cardiff University Centre for Automotive Industry Research and British Telecommunications, 2001.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Offer to readers

Sep 2nd 2004
From The Economist print edition

Reprints of this survey are available at a price of £2.50 plus postage and packing. A minimum order of five copies is required.

Send orders to:

The Economist Shop
15 Regent Street, London SW1Y 4LR
Tel +44 (0)20 7839 1937
Fax +44 (0)20 7839 1921
e-mail: shop@economist.com

Corporate offer

For corporate orders of 500 or more and customisation options, please contact the Rights and Syndication Department on:

Tel +44 (0)20 7830 7000
Fax +44 (0)20 7830 7135
or e-mail: rights@economist.com

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Bloomberg

Missing Mike

Sep 2nd 2004
From The Economist print edition

EPA

A media and data business is pining for its inspirational leader

Get article background

MANY a successful company has faltered after the departure of its charismatic founder. On the surface, the media and financial-information firm that Michael Bloomberg built is still thriving despite his sudden career shift in 2002, when the billionaire left to become mayor of New York. The story of how Bloomberg trounced Reuters, a British company that used to dominate the market, is an oft-cited business classic—thanks not least to Mr Bloomberg's own self-congratulatory but insightful telling of it in a book, “Bloomberg by Bloomberg”. Yet there are signs that all is not well. Mr Bloomberg's exit is proving a big loss for the firm's risk-taking and unusually tough corporate culture (which the mayor is now trying to replicate in New York's traditionally flabby City Hall). Maintaining growth at the firm in the longer term could be difficult.

Mr Bloomberg's great innovation, in the early 1980s, was to put historic and current price data for bonds and shares together with analytic tools into a desktop terminal sold to financial firms that was easy to use and backed by exceptional customer service. He spotted this opportunity while working at Salomon Brothers, then the most aggressive firm on Wall Street. He then went on to set up Bloomberg News, a global service that, with Bloomberg TV, radio and a group of finance magazines, gives the firm stature (if not much revenue, as yet) well beyond the financial markets.

At the end of 2003, according to *Inside Market Data Reference*, a research publication, Bloomberg had sold nearly 180,000 of its terminals, capturing 43% of the $7 billion market-data industry. Last year, for the first time, its revenues in this market exceeded those of Reuters. It now dominates the top end of the market—which may be why Mr Bloomberg decided to place his firm in the hands of a management team that seems not to be inclined to change much or take big risks. Neither the chief executive, Lex Fenwick, a former salesman, nor the chairman, Peter Grauer, previously an investment banker, has a reputation for innovation. People at the firm describe them as caretakers for the mayor. Mr Bloomberg still owns 72% of the firm he created, and he is allowed to take an interest in significant developments at the firm.

Wish they could be like Mike

Morale at Bloomberg has suffered under the new team. Mr Bloomberg always demanded long hours and absolute loyalty from his employees. But at the same time he was an inspiring leader who made it clear to employees that he cared about their welfare. That feeling is lacking under the current management, some insiders say. Disgruntled staff are using two websites to express their frustrations publicly, and the Newspaper Guild in New York launched a campaign this spring to get journalists there to unionise.

“We've seen more Bloomberg résumés in the last six months than in the last ten years,” gloats Tom Glocer, boss of Reuters. Mr Glocer says he has heard that working at Bloomberg is far less fun without its founder. Bloomberg counters that it has received a record number of applications to work there this year, and that global employee turnover is only about 8% a year.

A particular reason for several recent departures is the allegedly abrasive management style of some senior executives at Bloomberg News. This has recently become a matter of concern in the Bloomberg boardroom.

Mr Bloomberg could probably solve such management problems without returning to the firm (which people close to him say he never will). A trickier issue is how to keep it growing. Once Bloomberg could increase the number of its terminals by more than 20% a year. The rate slowed to about 5% in 2002-03, and a healthy 8% so far this year. But many of those who could make use of its terminals now have them. The banking industry is consolidating.

With a strategy in its media business of incremental growth, at best, what remains of Bloomberg's entrepreneurial energy is now directed at other areas that its rivals currently dominate. “It's very important that we don't sit still,” says Mr Fenwick, “and we won't.” Soon it will launch its “fat pipe”: a feed of raw market data that hooks up to the back office of a bank to update its trading applications. Reuters rules this market now. Last year Bloomberg teamed up with a currency-dealing network called EBS to take on Reuters in foreign-exchange. Beating Reuters may be harder this time around, for the venerable firm has woken up and is battling hard to save its franchise.

The big question facing Bloomberg in data is whether to keep making only its expensive one-size-fits-all product for high-end customers. The market-data industry is evolving, says Lou Eccleston, an ex-head of product strategy at Bloomberg who joined rival Thomson Financial in 2002, in a way that will help firms that are flexible and willing to build customers' proprietary data into products with affordable customised features. Bloomberg has considered selling “Bloomberg-lite”—cheaper, with fewer functions—but rejects the idea of tailoring for now.

After all, traders still love its product. As well as prices and analytic tools, the Bloomberg terminal has an e-mail system with the addresses of everyone who matters in the market. Traders in the City of London love its restaurant reviews which, among other things, advise on whether the women customers are good-looking.

But Bloomberg has made itself unpopular with the people in charge of market data at banks, who say that it has turned from plucky upstart into arrogant giant. They were angry in 2003 when it stuck to its customary two-yearly price rise even though banks were reeling from a market downturn. They say that Bloomberg's new initiative to scan users' fingerprints is all about stopping terminal-sharing—a move that could translate into an effective price rise of 10%, says one global bank. Above all, they worry that Bloomberg could disintermediate them by connecting their clients to each other. “There's the cost of Bloomberg and then there's the strategic risk, and how do you put a price on that?” says one New York banker.

One industry-wide initiative to develop better instant messaging is partly an attempt to dislodge Bloomberg's e-mail system, says a person involved in it. Another market-data manager has started a project to monitor usage of terminals, to show senior management that many people use only a fraction of the functions and could do without them. In the future, banks say that they will help Bloomberg's rivals where they can—especially Thomson Financial, the smallest of the big three. For now, there is no obvious new threat to Bloomberg. But eventually, says the head of market data at one big investment bank, a challenge will come from a firm that uses the internet, rather than a proprietary system, to deliver market data.

Mr Bloomberg has talked in the past about selling his company to the Thomson Corporation, a big family-controlled firm based in Canada that owns Thomson Financial. But he asked for more than it wanted to pay. More recently there has been speculation that Microsoft wants to buy Bloomberg. It is not for sale, says Mr Fenwick. If it can find some growth and its terminals continue to bring in billions, Mr Bloomberg

may conclude that there is no need to sell or bring in a new management team. But having got to the top, it may struggle to stay there, just as Reuters did.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Corporate scandals

The chronicles of greed

Sep 2nd 2004
From The Economist print edition

Hollinger International turns its guns on its board of directors

FOR the past 14 months, a special committee at Hollinger International, a newspaper firm, has been working on a report about how Conrad Black, its majority shareholder, allegedly looted the company. The result was certainly worth the wait. “The Hollinger Chronicles”, as the committee has styled the report, are as remarkable a tale of alleged excess as any in the history of joint-stock companies.

During 1997-2003, according to the committee headed by Richard Breeden, a former head of the Securities and Exchange Commission, Lord Black and his associates wrongly took over $400m from Hollinger International—an amount that was equal to 95.2% of the company's profits during that time. In May this year the firm filed a lawsuit against Lord Black and some of his colleagues which demands that they pay $1.25 billion. But this week's report contains further allegations: for instance, that Lord Black and his wife, Barbara Amiel Black, engineered a swap of flats in New York so that they acquired the company's property for $2.5m less than it was worth.

Then there are details of what the Blacks charged to Hollinger International, of which Lord Black and his associate, David Radler, own 18.8%. The firm paid for opera tickets, and silverware for Lord Black's corporate jet, and for Lady Black it bought perfume, handbags, jogging clothes and a $42,870 birthday party at a restaurant, La Grenouille, in New York. Lord Black's company, Ravelston, said this week that the report is a mixture of “exaggerated claims laced with outright lies.”

The report has been eagerly awaited not least to see how much blame it would heap on Hollinger International's directors for failing to stop the alleged looting. The answer: a great deal. Current and former board members can expect this week's report to be used against them in court.

On Hollinger International's audit committee were James Thompson, a former governor of Illinois and chairman of a law firm; Richard Burt, a former American ambassador to Germany; and Marie-Josée Kravis, wife of a famous financier, Henry Kravis. The report repeatedly describes the committee's passivity and inaction in damning terms. In 1999, for instance, Lord Black charged Hollinger International $40m in management fees, an amount that the special committee says was vastly inflated. But when he sold some publications representing roughly half of Hollinger International's revenues to CanWest, a Canadian publishing firm, the report says, he agreed with the buyer that it would pay him an annual management fee of just $3.9m. Why did neither the audit committee nor anyone else on the Hollinger International board notice this “glaring anomaly,” asks the Hollinger Chronicles. In the audit committee's favour, however, the report says that Lord Black often misled the board, and that its members co-operated fully with the company's investigation.

The report alleges that Richard Perle, a former chairman of the Pentagon's Defence Policy Board, is personally liable for his “abject failure to fulfil his fiduciary duties”. As head of an executive committee at Hollinger International, it says, he repeatedly failed to “read, evaluate, discuss or attempt to understand” documents that he signed that facilitated Lord Black's wrongdoing. The report says that Mr Perle should return over $5m he received from the firm.

Some other board members will rest easier as a result of the report, however. Two independent directors, Henry Kissinger and Shmuel Meitar, an Israeli businessman, it says, acted reasonably in relying on the audit committee.

One looming lawsuit against Hollinger International's directors is from Cardinal Value Equity Partners, a shareholder in Hollinger International. More are likely to follow. Cardinal's suit was filed in January, but the firm agreed to stay it while the firm conducted its investigation. Gene Fox, a managing director at

Cardinal, is particularly happy with the report. The investigating process has been criticised for costing $25m, but given the fact that Hollinger International has already got $42m of its money back, he says, “the money spent on this has been the best investment Hollinger International has ever made.”

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

French business

Fiscal favours

Sep 2nd 2004 | PARIS
From The Economist print edition

Vivendi is the latest firm to benefit from France's discriminatory taxes

NICHOLAS SARKOZY, France's ambitious finance minister, is unceasing in his creativity when it comes to helping the country's business champions—and, by helping them, helping to further boost his popularity. More often than not, his creativity brings him into conflict with the eurocrats in Brussels, a fact that itself may do his career the world of good. He seems to view his controversial rescue of engineering group Alstom and his call for there to be a French buyer of Aventis, a drug firm, as badges of honour. On August 26th Mr Sarkozy added another, when he gave Vivendi, a media company still struggling to recover from over-expansion during the recent bubble, permission to switch to a tax regime that will unlock tax credits worth up to €3.8 billion ($4.6 billion) in the next five years. In return, Vivendi has promised to create 2,100 new jobs, most of them in economically struggling areas of the country—a promise that may not mean much in practice.

Vivendi joins a select club of a dozen or so French blue-chips, including Total, Areva, Thomson and Saint Gobain, taxed under the *bénéfice mondial consolidé* (BMC). These can consolidate for French tax purposes the profits and losses of all their affiliates at home and abroad. Other French firms fall under a territorial tax system, in which foreign subsidiaries are taxed by the country where they are based.

As with many of Mr Sarkozy's cunning plans, Brussels suspects foul play. The competition authorities are taking a hard look at Vivendi's new tax treatment to determine whether it is a hidden form of illegal state aid. The European Union, at least for now, generally has no power over tax policy in member countries. However, it can block a government's actions that discriminate in favour of some firms relative to others. But does the treatment of Vivendi fall into that category? Defenders of the French system say it is not discriminatory because all companies can apply for BMC. Indeed, but applying successfully is quite another matter. To gain BMC treatment usually involves prolonged negotiations that are anything but transparent—making it hard to know if there is discrimination taking place. So far, only some big multinationals that promise the French government something attractive in return, such as the creation of hundreds of jobs in deprived parts of France, have got the finance ministry's go ahead. The European Commission will only be satisfied if there are objective standards by which a company is placed under the consolidated global system, says Howard Liebman, a lawyer at Jones Day in Brussels.

About ten years ago the European Commission proposed a directive to allow multinationals to consolidate profits across union borders, but it was never approved. A case now before the European Court of Justice, brought by Marks & Spencer, a British retailer, may force member states to decide between offering global consolidated taxation to all firms or to none.

Meanwhile, there remains the question of what impact the new tax treatment will have on Vivendi's attractions as a merger partner—presumably, this being France, for another French firm. Rumours of a merger between Vivendi and Lagardère, a French media and defence company, have resurfaced repeatedly during the past couple of months. Arnaud Lagardère, boss of Lagardère, who says he wants his company to become the third-largest media company in the world, is especially keen on Canal Satellite, a satellite operator that is part of Canal Plus, Vivendi's pay-TV channel (Lagardère already owns a big stake in Canal Satellite).

Yet even before the announcement of the tax deal, analysts at Morgan Stanley reckoned that such a merger was unlikely because of the high price the much smaller Lagardère would have to pay (which would now be even higher, thanks to Vivendi's lower tax bill), the innate conservatism of Lagardère's management and the unwieldiness of the conglomerate that would result from the combination of the two groups. Moreover, it is hard to see how, after such a merger, Lagardère could continue to be a *commandite par actions*, a sort of managing partnership that gives Mr Lagardère power over his company

out of proportion to his family's investment in it. But perhaps Mr Sarkozy could find an ingenious way to deal with that.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Beer in Russia

Beyond vodka

Sep 2nd 2004
From The Economist print edition

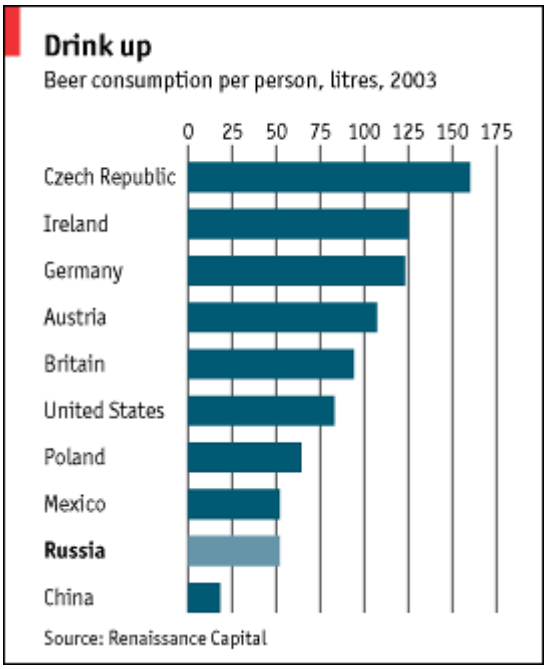
Despite new anti-booze regulations, Russia is a brewer's dream

AFP

A disapproving look from the president

RUSSIANS are famously hard drinkers—a trait epitomised by former president Boris Yeltsin. By contrast, the current president, Vladimir Putin, is teetotal, and has declared war on the demon drink. He recently approved a new law that will soon ban beer ads featuring "images of people or animals." On September 5th, the first phase of the law will confine beer commercials to the little-watched late night slot. Yet Russia is likely to remain a booming market for brewers.

Liquor ads have been banned from TV since 1995, but beer—regarded by vodka-hardened Russians as practically a soft drink—has not hitherto been regulated in Russia. It is sold to minors and in fast food restaurants, and is freely consumed on the streets and in tube stations. Last year was the first since the 1998 crisis that the beer market grew by less than double digits—but at 7%, it still rivals China for the fastest growth in the world. It is set to continue as Russians are weaned off vodka, still the tipple of choice. An average Russian drank less than 52 litres of beer last year, about half what an average Brit swigged (see chart).



And the binge is on. Dutch-based Heineken announced on August 10th that it would buy two regional Russian breweries, helping it to expand outside Moscow and St Petersburg and to reduce transportation costs. Heineken is now the third-largest firm in the Russian market, trailing SUN Interbrew, which has 16% of sales. On August 12th, Belgian-based Interbrew announced a buy-out of its joint-venture partner for a 40% premium. It now controls 91% of the business that sells standard and licensed brands such as Stella Artois. The market leader, with a third of all sales, is Baltic Beverages Holding (BBH)—owned 50-50 by Danish brewer Carlsberg and British group Scottish & Newcastle. BBH controls Baltika, Russia's biggest and most recognised brewery, whose shares look like a bargain in comparison with those of SUN Interbrew. BBH was a rare sales success for Carlsberg in the second quarter of this year; the Danes have vowed to maintain their market share, at all costs.

There still remain several small outfits for foreigners to swallow. But the industry has largely consolidated, and the top firms now face the challenge of organic expansion in a poor country. Brewers have established remarkably good distribution networks given Russia's vast size, but they can do little to raise prices. An average bottle in Russia costs just 14 roubles ($0.48), according to the United Financial Group, an investment bank. Sales of premium brands are growing at twice the overall rate. But with Russia's median salary just over $200 per month, these will remain niche products, albeit with better profit margins than the value brands. Meanwhile, increasing competition restrains prices even as it swells marketing costs. Double-digit general inflation has not helped either. Alexei Yazikov, consumer goods analyst at Aton, a brokerage, says that one saving grace has been cheaper inputs: brewers import over half of the malt that they use and have been paying for it with a weakening dollar.

As for the ad ban, it will largely hit micro-breweries, or newcomers with a brand to establish. Even so, advertisers are at a loss to explain how it will work in a country with 11 time zones during, say, a live broadcast, or whether trademarks based on animals will have to be redrawn. Hard-liquor producers have got round their ban by advertising other products, such as chocolates, with curiously similar logos. “The real fun will be watching what kind of loopholes [the beer industry] will find,” says Mr Yazikov. Expect a flurry of commercials for Baltika mineral water.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Microsoft

Bug trouble

Sep 2nd 2004
From The Economist print edition

Microsoft's increased focus on security is having unintended consequences

Get article background

IN RECENT years, Microsoft has focused on three big tasks: building robust security into its software, resolving numerous antitrust complaints against it and upgrading its Windows operating system. These three tasks are now starting to collide.

On August 27th the firm said that the successor to its Windows XP operating system, code-named Longhorn, will go on sale in 2006 without one if its most impressive features: a technique to integrate elaborate search capabilities into nearly all desktop applications. (On the bright side, Longhorn will contain advances in rendering images and enabling different computing platforms to exchange data directly between applications.) It is a big setback for Microsoft, which considers search technology a pillar of its future growth—not least as it competes against Google.

The firm's focus on security—championed by Bill Gates himself—took resources away from Longhorn, admits Greg Sullivan, a lead product manager in the Windows client division. Programmers have been fixing Windows XP rather than working on Longhorn. In mid-August, Microsoft released Service Pack 2, a huge set of free software patches and enhancements to make Windows XP more secure. Though some of the fixes turned out to have vulnerabilities of their own, the patches have mostly been welcomed. Microsoft's decision to forgo new features in return for better security is one that most computer users will probably applaud.

Yet ironically, as Microsoft slowly improves the security of its products—by, for instance, incorporating firewall technology, anti-virus systems and spam filters—its actions increasingly start to resemble those that, in the past, have got the firm into trouble with regulators. Is security software an “adjacent software market”, in which case Microsoft may be leveraging its dominance of the operating system into it? Integrating security products into Windows might be considered “bundling” which, with regard to web browsing, so excited America's trustbusters in the 1990s. And building security directly into the operating system seems a lot like “commingling” software code, on which basis the European Commission ruled earlier this year that Microsoft abused its market power through the Windows Media Player. Microsoft is appealing against that decision, and on September 30th it will argue for a suspension of the commission's remedies, such as the requirement that it license its code to rivals.

Just last month, the European Union's competition directorate began an investigation into Microsoft and Time Warner, a large media firm, on the grounds that their proposed joint acquisition of ContentGuard, a software firm whose products protect digital media files, might provide Microsoft with undue market power over digital media standards. The commission will rule by January 2005. Microsoft, it seems, in security as elsewhere, is going to have to get used to being punished for its success. Its Windows monopoly lets it enjoy excessive profits—but the resulting monoculture makes it an obvious target for viruses and regulators alike.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Electricity in Japan

A healthy jolt

Sep 2nd 2004 | TOKYO
From The Economist print edition

Why the coming privatisation of J-Power is worth celebrating

IT WILL be the biggest Japanese initial public offering (IPO) for six years. But, hopefully, the privatisation of the Electric Power Development Company, otherwise known as J-Power, will also be a big deal in other ways. J-Power is expected to be listed on the Tokyo Stock Exchange in early October, and to raise perhaps ¥350 billion-400 billion (over $3.2 billion). That is around 50% more than the ¥250 billion raised in the listing of Shinsei Bank earlier this year. The privatisation also marks an important step forward in Japan's gradual attempt to liberalise its power sector.

J-Power is a peculiar creature. After the second world war, the American occupiers broke up Japan's national power company into nine privately-owned utilities, each with its own regional monopoly. After the Americans left, Japan's government set up a tenth, publicly-owned, utility, J-Power, to supplement the regionals and give the bureaucrats their own toy to play with. Since it generates power nationwide—it is Japan's biggest wholesale electricity supplier—J-Power's privatisation should give it more incentive to compete with the regionals. Competition from J-Power and new entrants will matter even more after next April, when a further stage of liberalisation begins.

That will involve three important reforms. The first will be the offering of competitive electricity services to more users. The regional utilities will lose their monopoly over mid-sized customers, such as small businesses and apartment buildings. Currently, alternative suppliers are allowed to offer electricity only to big businesses, such as power-hungry department stores and factories. Once mid-sized customers join them, roughly two-thirds of Japan's energy users will have access to competitive power generation.

That competition should go a lot further once the other two reforms take effect. A new energy-trading exchange will be established to make it easier for power generators to sell electricity along the national grid. This exchange will be backed up by a new semi-regulatory outfit, which will monitor tariffs across regions and try to ensure that the regional utilities are not able to impede competition.

Much will depend on how well the traders and the new network monitors do their jobs. Currently, the nine utilities maintain artificial price barriers that impede the flow of power in and out of their regions and prevent new entrants from making full use of the national grid, which links all of the regions except Okinawa. The regional utility in southern Kyushu, for example, often has surplus power that it is keen to sell to other parts of the country; and when there is peak demand in Japan's faraway capital, Tokyo Electric Power is eager to buy it. But whenever these two firms want to strike a bargain, they must also deal with the three regional utilities in between, which are usually keen to extract a price for letting power flow to where it wants to go.

If the trading market works as intended, that sort of behaviour will fade, encouraging J-Power and other new entrants to compete for business. Japan's giant commercial trading companies, always eager for new business opportunities, seem keen on the proposed market. Mitsubishi Corporation, Mitsui and Marubeni, for example, are all hoping to make significant profits from buying and selling electricity. America's Enron was once keen to join them, and its demise offers a warning of how badly such schemes can go awry. But if energy trading in Japan launches successfully, it will prove an even bigger deal than next month's IPO.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Coal-fired electricity

The future is clean

Sep 2nd 2004
From The Economist print edition

Coal is costly, but coming back into favour—and cleaner

MORE of the world's electric power comes from coal than from oil and gas together: a third of Britain's, half of Germany's or America's, three-quarters of India's or China's. And the fuel has one huge advantage: it does not come from the Middle East. But, thanks not least to China's rapid economic growth, the price of coal has doubled since January. No wonder the governments of coal-rich countries are content, the firms that dig it up are rubbing their hands, while the users are looking hard for more efficient ways of burning the stuff.

On the supply side, prospects have been transformed. Analysts foresee America's biggest coal-miner, Peabody Energy, trebling its profits between the first quarter of this year and the last. Europe's biggest miner, Poland's state-backed Kompania Weglowa, with 79,000 employees, was losing nearly $30m a month early last year; it is now making a monthly profit of $10m. Giant shippers such as Australia-based BHP Billiton and Xstrata, exporting from Australia and South Africa, have reported surging profits. China's big state-owned Shenhua group may sell some of its equity. Even in Britain, which once mined 280m tonnes of coal a year and now digs one-tenth of that, the main operator, UK Coal, can imagine a future for what until recently seemed to be a dying industry.

Users agree. American power companies are returning to coal. But everywhere there is one huge problem: the environment. Even the much-denounced Chinese in fact know that they must clean up power generation, and have begun to do so. The rules in western countries are tight. Getting permission for a coal-fired plant can take years. In 2000, only two such were planned in all of America. Today, there are dreams for nearly 100—but only a half-dozen are actually being built.

Yet coal need not be a filthy fuel. Apart from “scrubbing” emissions, modern combustion techniques can clean them before they start—and use less coal too. A century ago, power plants produced maybe 5% of what their coal could, in theory, deliver; today, about 35%. Pulverising the coal can make this 40-45% (unless it is moist, “sub-bituminous” coal, and Japanese scientists are working on that). With a high-temperature burn, over 50% may be possible. Less coal burned, fewer nasty emissions; an American version of this, given the go-ahead in 2000 but not yet built, would have cut some of them too. “Fluidised-bed” combustion—coal is burned on a bed of particles suspended in flowing air—also can exceed 40%, and prevent or capture most of the emissions as well. Developed since the 1960s, it is widely used.

Bolder techniques lie ahead. Coal can be burned with oxygen instead of air. It can be gasified (even, perhaps, *in situ*), the gas going to power a gas turbine, surplus heat to make steam for a conventional one; a big American generator, AEP, this week said it is to build such a plant. Noxious emissions can thereby be greatly reduced; even to zero, claims a California firm working on one version. America's Department of Energy is working on a hybrid of gasification and combustion.

There is a mass of research into such ideas, much of it, as in Canada and Australia, powered by a joint get-together of the big coal-users and government. Will it pay? And how soon? Much depends, now, on legislation. The Netherlands subsidises zero-emission electricity; Norway heavily taxes carbon-dioxide emissions. But Britain's subsidy for “renewable-source” electricity does not (to the distress of those who would profit) go to coal, however virtuously used. American state laws tend to punish emissions—to the point where some plants sit idle for most of the time—but not to reward the virtuous. So the incentives to speed ahead differ. But within 15 years, new coal plants could be as clean as any others, and just as profitable.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

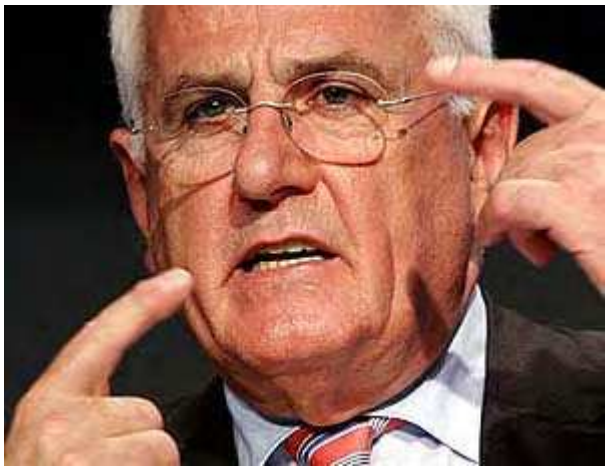
Face value

Two Hartz beat as one

Sep 2nd 2004
From The Economist print edition

Peter Hartz is a double agent of change in Germany

AP



HIS name has become a sort of expletive, just because he headed a government commission that has blown a hole in Germany's cherished social safety net. From January, Hartz IV, the deeply unpopular final phase of the commission's lawmaking, will force the rich-but-struggling economy's long-term unemployed to find work or face a new level of (relative) poverty. Every Monday for the past few weeks tens of thousands of protesters have taken to the streets to try to stop the reform.

Hartz, the law, is the butt of placards, graffiti and furious letters in the media. Peter Hartz, the man, a mild person by all accounts, is about to face another storm thanks to his day job, as head of personnel at Volkswagen (VW). Germany's biggest carmaker is squaring up for fierce wage negotiations with its employees, represented by the mighty blue-collar union IG Metall.

Last week Mr Hartz fired his opening shot by calling a press conference and stating categorically that any wage increase is out of the question. The union wants a 4% wage hike and job security for ten years. Negotiations are due to begin on September 15th. Failing an agreement, union bosses do not rule out a strike.

VW is in trouble, after two years of flagging sales. Bad marketing and misguided management decisions have left it with models, such as the luxury Phaeton, built in a special show factory in Dresden, that are not selling. In the past, Mr Hartz, who clearly hates to fire people, has always found a compromise, in the traditionally consensual German way. In 1993, the year he joined VW, the hard numbers argued for laying off 30,000 workers. Instead, he introduced a four-day week and trimmed the average wage by 15%. In 2001, to justify building a new factory in Lower Saxony rather than in low-wage eastern Europe, Mr Hartz devised an innovative employment model to side-step the union wage agreement. For Auto 5000, which started building Touran minivans last year, a brand-new workforce was recruited from among the unemployed. These workers are organised in “families” and paid, in part, according to performance.

Now Mr Hartz wants to extend this concept to VW's core German operations, making 30% of salaries performance-related and treating workers as what he calls “co-entrepreneurs”. He also plans “internal competition” whereby different VW factories may bid to produce new models. As a sweetener, VW managers are prepared to freeze their pay too. But will Mr Hartz carry the workforce with him this time, or has his luck run out?

Some other big firms have already had a showdown with IG Metall. Siemens threatened to move production of mobile phones to Hungary unless its workers accepted longer working hours for no extra pay. IG Metall caved in to what it called “blackmail”. With DaimlerChrysler, IG Metall won a degree of compromise: it preserved the 35-hour week, hallowed in Germany, but gave some ground on working hours for research and service staff, and on future cost reductions. Opel, the hard-hit German subsidiary of General Motors, is likely to win concessions from IG Metall because its sales have collapsed.

But IG Metall may not yield so easily to VW, a firm with which it has long boasted of a special relationship. Some 97% of the workforce are union members, including an estimated 75% of the management—even Mr Hartz. VW is special in the eyes of the government, too. Gerhard Schröder, the chancellor, sat on VW's supervisory board as prime minister of Lower Saxony (the Lower Saxony government still owns 18% of the firm). Laying off workers at VW is fraught with political difficulty.

Mr Hartz's skill, so far, has been to find compromises that avoid lay-offs. He has become known in Germany as the human face at the negotiating table, with a flair for pulling solutions out of a hat. As a director of the stricken steel firm, Saarstahl, in the 1980s he softened lay-offs with a job-creation scheme. His four-day-week solution at VW was seen, in the relatively prosperous 1990s, as a way of enhancing quality of life and extending leisure time. The “company that breathes” is how he described his philosophy of labour relations in a book of that name.

His closeness to the Social Democrat party led Mr Hartz to co-found a group of industrialists that backed Mr Schröder's re-election in 2002. He refused several times the chancellor's offers to join his cabinet. But in 2002 he agreed to head a new commission to “modernise the labour market” which, for better or worse, came to bear his name. The Hartz laws I to III have tried to make job-seeking and job-seekers more entrepreneurial, revamping the Federal Jobs Agency and encouraging part-time “mini-jobs” and one-man firms called “Ich-AGs”. Hartz IV, voted into law in July, limits unemployment pay to the first year out of work, after which much lower, and means-tested, social security benefit will be paid. From January, opting for unemployment will not be the cushy alternative to working that it was for decades, when it contributed mightily to Germany's economic stagnation. In some parts of former East Germany, where unemployment levels reach 20%, the shock will be cruel. But even in the east the looming deadline has miraculously increased the number of people actively seeking and finding jobs.

Lonely Hartz

As Mr Hartz prepares for the showdown at VW, it can hardly help that his name is being dragged through the mud. His public declaration last week hints of a change of tactics, too, by a man who usually bargains behind closed doors. He may have concluded that VW, with labour costs 11% higher even than its German rivals, cannot compromise this time. Arguably, his past compromises made VW less competitive. Now he wants to cut VW's labour costs by 30% over the next seven years. Why, thunders a union spokesman, should innocent workers be punished for the mistakes of managers and marketing directors. Can Mr Hartz's vision of the worker as co-entrepreneur survive?

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economist.com BUSINESS
PRINTABLE PAGE VIEW SPONSORED BY
About sponsorship

Mobile 3G telecoms

Vision, meet reality

Sep 2nd 2004
From The Economist print edition

After years of delay, third-generation (3G) mobile-phone networks are finally being switched on. How will the reality compare with the original vision?

Get article background

THE biggest ever gamble on the introduction of a new technology; an attempt to maintain growth in a maturing industry; or an industrial-policy fiasco? The introduction of "third-generation" (3G) mobile-phone networks around the world is all these things and more. In 2000, at the height of the dotcom boom, mobile operators around the world, but mainly in Europe, paid a total of €109 billion (then $125 billion) for licences to build and operate 3G networks, which offer higher performance and more capacity than existing second-generation (2G) networks. In part, the mobile operators were victims of their own hype. A report that year from the International Telecommunication Union, the industry's standards body, gives a sense of the high hopes for 3G:

> The device will function as a phone, a computer, a television, a pager, a videoconferencing centre, a newspaper, a diary and even a credit card...it will support not only voice communications but also real-time video and full-scale multimedia. It will automatically search the internet for relevant news and information on pre-selected subjects, book your next holiday for you online and download a bedtime story for your child, complete with moving pictures. It will even be able to pay for goods when you shop via wireless electronic funds transfer. In short, the new mobile handset will become the single, indispensable "life tool", carried everywhere by everyone, just like a wallet or purse is today.

Dotcom mania aside, the industry had concluded that 3G networks would make possible new services to provide growth as its core business, voice telephony, matured. As the proportion of people with mobile phones has increased—it now exceeds 85% in much of the rich world—the average revenue per user (ARPU), a key industry metric, has levelled off. This is because the most valuable subscribers were the first to buy mobile phones; later adopters make fewer calls and spend much less. With subscriber numbers reaching saturation, at least in the rich world, the industry began casting around for new sources of growth, and fancy services such as video and internet access seemed the most promising prospects. Hence the appeal of 3G.

Even so, forking out €109 billion for 3G licences—plus roughly the same again between 2001 and 2007 to build the actual networks, according to predictions from iSuppli, a market-research firm—was an enormous gamble, arguably the biggest in business history. But in many cases operators had no choice. Several European countries held auctions for their 3G licences in which operators bid huge sums: in

Britain and Germany, for example, operators ended up paying around €8 billion for each 3G licence. Why? Because with their 2G networks filling up, and with no additional 2G capacity on offer from regulators, operators felt compelled to buy 3G licences to ensure scope for future growth. Andrew Cole of A.T. Kearney, a consultancy, remembers when a client who was taking part in the auction received the order to “win the licence no matter what”. The €109 billion was, in effect, a tax on the right to continue to do business. Few firms were brave enough to refuse to pay up.

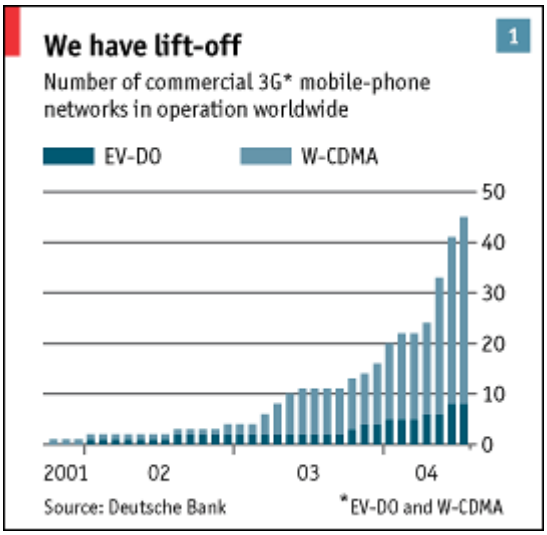
So the 3G adventure got off to a bad start in Europe by nearly bankrupting the industry. Since 2000 most operators have written down the value of their 3G licences. Some even handed the licences back to the governments from which they bought them, rather than commit themselves to building expensive new 3G networks within strict time limits. (Reselling the licences was forbidden.) The whole episode is now something the industry would rather forget. “The spectrum auction is a nightmare the operators don't want to remember,” says Mr Cole. “I haven't heard it mentioned in a long time.”

Ready, steady, flop!

The pioneering launch of 3G services at the end of 2001 in Japan and South Korea, the world's two most advanced mobile markets, did little to lighten the mood. In both countries, operators were using 3G technologies different from the W-CDMA standard (which is also known as UMTS) being adopted in Europe. An unproven technology, W-CDMA was plagued by teething troubles: base-stations and handsets from different vendors would not work together reliably, and early handsets were bulky and temperamental. Operators postponed the launch of 3G services from 2002 to 2003 and then to 2004, though a handful chose to launch sometimes shaky 3G services earlier.

Yet now, at last, the 3G bandwagon is starting to roll. According to figures from Deutsche Bank, there were 16 commercial 3G networks worldwide at the beginning of the year, and there will be around 60 by the end of the year (see chart 1). Matti Alahuhta, head of strategy at Nokia, the world's largest handset-maker, says the second half of 2004 will be seen as “the starting point for the global acceleration of 3G”. Nokia and other handset-makers have high hopes for the Christmas market. The early, brick-like W-CDMA handsets have given way to much smaller, sleeker models. In Japan and Korea, sales of 3G handsets are booming. Even in America, that wireless laggard, 3G services have been launched in several cities, and the country's largest operators have committed themselves to building 3G networks.

Having swung too far towards pessimism, the industry is now becoming cautiously optimistic about 3G, says Tony Thornley, the president of Qualcomm, the firm that pioneered the technology that underpins all of the various technological flavours of 3G. Qualcomm has announced that it is having trouble meeting demand for W-CDMA radio chips. “As we get very near to seeing these things become a reality, we become more optimistic about what 3G can deliver,” says Peter Bamford of Vodafone, the world's largest mobile operator. So now that it is finally happening, how does the reality of 3G stack up against the original vision?



Less data, more voice

That depends upon whom you ask. Mr Bamford, for example, denies that there has been any downgrading of the original vision. But he is at the most optimistic end of the spectrum, a view reflected in Vodafone's reluctance to write down the value of its 3G licences. Most observers agree that there has been a shift in expectations about how 3G networks will be used, away from video and other data services and towards traditional voice calling.

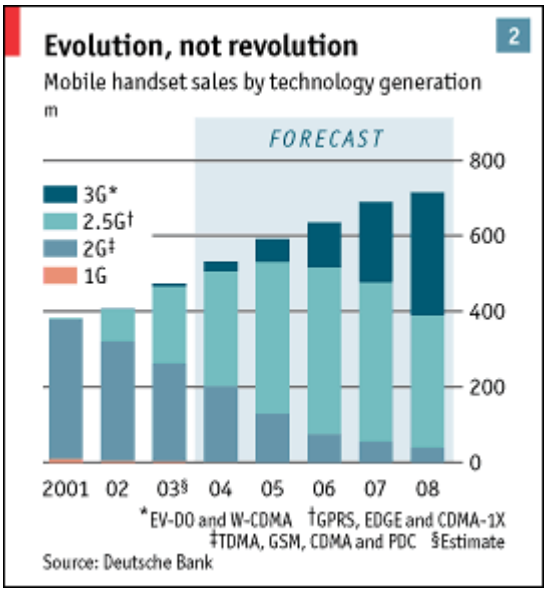
“Three years ago, everyone was talking about video-telephony,” says Mike Thelander of Signals Research Group, a consultancy. But while video-telephony sounds cool, the evidence from early 3G launches in Japan, South Korea, Britain and Italy is that hardly anybody uses it. Market research suggests that women are particularly reluctant to adopt it, says Mr Cole. Nokia's first mainstream 3G handset, the 7600, does not even support video calling, but nobody seems to mind.

Nor have the high hopes for data services been fulfilled—so far, at least. The idea was to encourage

consumers to adopt data services on 2G phones, paving the way for fancier services on 3G phones. But while text-messaging is hugely popular, with over a billion messages sent daily worldwide, other forms of wireless data such as photo messaging, news updates, and music and game downloads have proved much less popular with consumers in most countries—Japan and South Korea are notable exceptions.

Such services “are still embryonic, but are going to be very important,” insists Mr Cole. Today's advanced handsets, he notes, are disrupting many industries simultaneously, including photography, music and gaming. The handset is slowly coming to be seen as “the Swiss Army knife of life services”. But the changes will take years to play out, even though they are happening at breakneck speed. Mr Bamford likens the transformation in mobile phones over the past five years to the evolution of television over the past 40 years, from crude black-and-white to hundreds of digital channels in colour. “To expect customers to snap into this in five minutes is just unrealistic,” he says.

Enthusiasm for data is growing, just not very fast: data services now account for 16.3% of Vodafone's worldwide revenues, for example, up from 15% a year ago. So hopes of a breakthrough in mobile-data usage still persist. At the moment, most optimism surrounds the prospects for music downloads to mobile phones (the most advanced models of which can now double as portable music players). Downloading ringtones is already popular, so downloading entire tracks—something that is only really practical using a 3G network—is the next logical step. Motorola, the world's second-largest handset-maker, has just done a deal with Apple, whose iTunes Music Store dominates the market for legal music downloads. And Nokia has just done a similar deal with LoudEye, another online music store. But it is still too early to tell whether this will turn into a mass market and, if it does, whether it will prove profitable for operators.



Greater emphasis is being placed instead on 3G's ability to deliver cheap voice calls—for as well as being able to support faster data downloads than 2G networks, 3G networks provide vast amounts of voice capacity (typically three times as much as a 2G network) at a lower price (typically a quarter of the cost per minute). As a result, says Bob House, an analyst at Adventis, “operators' sights are now much more firmly trained on displacing voice from fixed networks.”

By offering large bundles, or “buckets” of minutes as part of their monthly tariffs, operators hope to encourage subscribers to use their mobile phones instead of fixed-line phones, and even to “cut the cord” and get rid of their fixed-line phones altogether—something that is already happening, particularly among young people, in some parts of the world. In America, for example, where large bundles are commonplace, subscribers talk on their phones for 700 minutes per month on average, compared with 100 minutes per month in Europe, where call charges are much higher, notes Mark Heath of Analysys, a consultancy. Since 3G networks offer voice capacity at a quarter of the cost of 2G networks, it ought to be possible for operators to offer larger bundles at a lower price per minute and still make money.

But operators must price their bundles carefully, and distinguish between peak-time and off-peak minutes, to avoid getting caught out. Offering generous bundle deals may, for example, cannibalise revenues from their most valuable customers, who will quickly switch to a better deal. Operators also want to avoid having to spend money adding expensive base-stations to the busiest parts of their networks to handle peak load. And, of course, they want to avoid a price war. Although everyone agrees that the advent of 3G will cause the price of voice calls to fall and margins to decline, operators are in no hurry to cut their prices before they have to.

But there are signs that Hutchison 3G, a new operator that has launched 3G services in several European countries under the “3” brand, is already leading the European market down this path, notes Mr Thelander: in some cases, 3 offers voice calls for a fifth of the price of its rivals. Further pressure on pricing, argues João Baptista of Mercer Management Consulting, will come as fixed-line operators combat the flight of voice traffic to mobile with ultra-low-cost telephony services based on “voice over internet protocol” (VOIP) technology. With price cuts, he says, “someone starts, and then you can't stop it.”

It would be a great irony if, after years of hype about data services, the “killer application” for 3G turned out to be boring old voice calls. In truth, however, nobody talks about killer apps any more. This reflects the realisation that 3G allows operators to offer lots of new services—music downloads, cheap voice calls,

wireless broadband access to laptops—but that the appeal of these services will vary widely from one group of customers to another.

“Unlike traditional voice service, the adoption of 3G services is very much customer-segment specific,” says Su-Yen Wong of Mercer. The lesson from Japan and South Korea, she says, is that “certain customer segments are interested in video, but others are not—some go for games, others for traffic updates.” The challenge for 3G operators, she says, is to understand the appeal of different services to different types of customer.

The challenge of segmentation

That will require careful market segmentation. “3G gives you more scope, and segmentation broadly becomes more important,” says Mr Bamford. The example of KTF, a South Korean operator, is instructive. It offers a service called Bigi Kiri to 13-18-year-olds (with unlimited text messaging between subscribers). Na, its brand for 18-25-year-old students, includes free cinema tickets and internet access at 68 universities; and Drama, another brand, caters to women. Other operators in South Korea and Japan do similar things.

The question for operators, says Mr Cole, is whether they can successfully appeal to all segments. At the moment, most operators have bland, generic brands that are intended to appeal to as broad a cross-section of the public as possible. But now they must decide whether to create sub-brands, or partner with other firms who are better able to appeal to specific demographic groups. There are already signs of this happening in many parts of the world as companies set themselves up as “mobile virtual network operators” (MVNOs).

Rather than build its own network, an MVNO teams up with an existing operator, and resells access to the operator's mobile network under its own brand. By far the best example is Virgin Mobile, an MVNO that resells airtime on T-Mobile's network in Britain, and Sprint's in America, to teenagers. The appeal for operators is that MVNOs enable them to reach out more effectively to customers. There has recently been a flurry of activity, with established brands including Tesco, 7-Eleven and MTV setting up as MVNOs.

Much of this activity has been prompted by the growing awareness that MVNOs are likely to have an important role in generating enough voice and data traffic to fill up those expensive new 3G networks. Since 3G phones can deliver graphics, music and video, large media firms, such as Disney, are actively investigating becoming MVNOs. Indeed, media giants might be more effective at driving uptake of data services than mobile operators, which are struggling to transform themselves from boring, technology-driven utilities into sexy consumer brands.

That in turn, suggests Mr Baptista, poses a long-term question for 3G operators: are they primarily network operators, or providers of services to consumers? No doubt some operators, with strong brands, will be able to hold their own against the likes of Disney. But second-tier operators might choose to focus on running a wholesale business, selling network capacity to others.

The calculations being made about the prospects for 3G are further complicated by the fact that the technology is still evolving, making new services possible. As things stand, the W-CDMA technology being adopted in much of the world has a maximum data-transfer rate of 384 kilobits per second. The rival 3G technology, called CDMA2000-1xEV-DO, which is already deployed in South Korea, Japan and parts of America, can deliver higher speeds of up to 2.4 megabits per second. In markets (such as Japan and America) where the two technologies compete side by side, W-CDMA operators are anxiously waiting for an upgraded version of the technology, called HSDPA, which will be faster still and will make its debut in Japan next year.

Faster, better, sooner?

Never mind what all those letters stand for: the point is that as its speed and efficiency improves, 3G technology may, in some markets, start to compete with fixed broadband connections. Other, more obscure flavours of 3G technology, such as TDD-CDMA (again, never mind) and CDMA450 can also be used in this way. In New Zealand, Woosh Wireless is offering wireless broadband service using TDD-CDMA, while backers of CDMA450 point to its unusually long range, which makes it ideal for providing broadband in rural areas, as well as telephony. This opens up yet another new market for 3G operators.

3G is evolving in other ways, too. In 2003, SK, South Korea's leading mobile operator, launched a video-on-demand service over its 3G network. Subscribers paid a monthly fee of 20,000 won ($17) for access, and could then have movies beamed to their phones (while commuting, for example) for 1,000 won each. The service proved so popular that the 3G network could not cope, and SK had to raise its prices dramatically, causing demand to collapse. But evidently video does appeal to 3G subscribers, provided it is cheap enough. So SK has now developed a hybrid satellite-cellular system. New handsets, to be launched this month, will have built-in satellite-TV receivers, offering 11 video and 25 audio channels. Meanwhile, both of the main 3G standards are being updated to allow for more efficient video broadcasts to handsets. Again, this could open new markets for 3G operators.

All of this makes it very difficult to answer the question of whether 3G will succeed, for 3G is a range of technologies that makes possible all kinds of new services. In Europe, 3G's main impact may simply be cheaper voice calls; in America, 3G may have most appeal to road warriors who want broadband access wherever they are; in the developing world, 3G could help to extend telephony and internet access into rural areas; and in South Korea and Japan, 3G might even—shock, horror—live up to the original lofty vision for the technology. The switching on of 3G networks around the world is not the end of the saga; the story continues to unfold.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Japan Post

Ready, steady, go

Sep 2nd 2004 | TOKYO
From The Economist print edition

AP

If it is done properly, the privatisation of Japan Post could boost competition in the country's financial markets. Trouble is, it might not be

Get article background

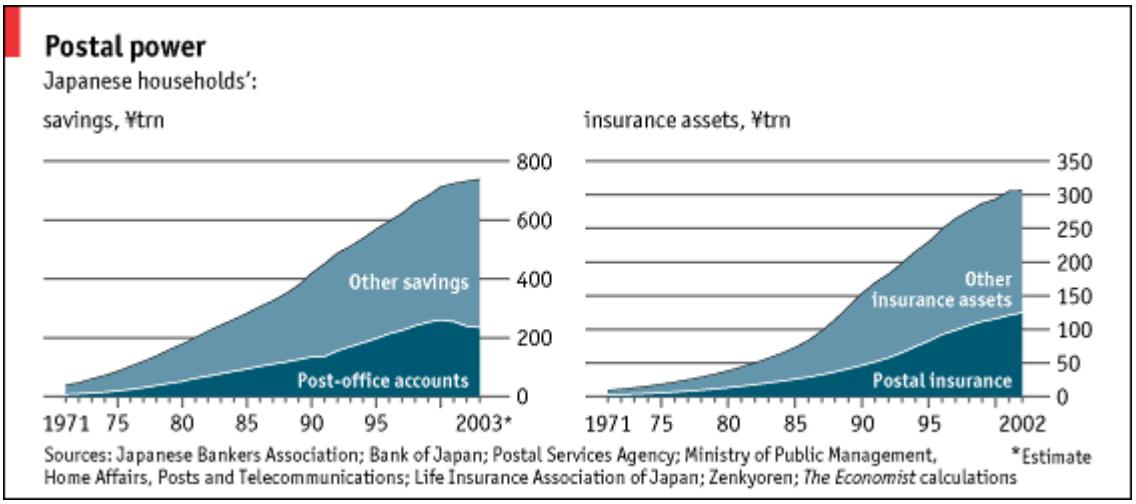
AT AN experimental sorting centre in Koshigaya, outside Tokyo, employees of Japan Post have been taking tips from Toyota. The civil servants handling Koshigaya's mail have learnt how to break tasks into manageable chunks, track their pace by the quarter-hour and rearrange sorting trays more efficiently. These are essential steps for an organisation that is due to face privatisation and competition in a couple of years. But sorting mail is only part of Japan Post's business and, oddly, not its most important one. For the company is also the world's biggest financial institution, the primary savings bank and provider of insurance to millions of Japanese.

Japan Post may be trying to learn from Toyota, but there is still a staggering difference between the two organisations. Toyota, like many Japanese exporters, is a globally minded company that innovates continuously to stay competitive. Japan Post, like much of the country's domestic service sector, is slow and has little need to compete. Toyota earned over ¥1 trillion ($9 billion) in profit last year; Japan Post received over ¥1 trillion in tax breaks and implicit subsidies.

It is little wonder, then, that Junichiro Koizumi, who became prime minister in 2001 promising “reform without sacred cows”, has long been keen to privatise Japan's postal system. This month, as he prepares to put the finishing touches to his plans for privatisation (in stages, beginning in April 2007), many proponents of market-based reform are urging him on. Those same enthusiasts, however, are also eyeing warily the conservatives in Mr Koizumi's ruling Liberal Democratic Party. If the LDP old guard succeeds in redrawing a few lines on the blueprint, the long-awaited privatisation could become a terrible missed opportunity.

Japan Post's pervasive influence on the financial system distorts competition and misallocates the country's huge pool of savings. It is sitting on ¥227 trillion in individual savings accounts, 30% of all such savings deposits (see chart). Post-office deposits are backed by government guarantee. Japan Post repays the favour by buying government-backed bonds, which finance a range of opaque, state-supported companies. Policies issued by the post office's life-insurance scheme, Kampo, are also

guaranteed by the government. Their value, ¥122 trillion, amounts to 40% of Japanese households' life-insurance assets. The figure for Kampo's closest rival is about ¥36 trillion. Together, Japan Post's savings and insurance schemes contain a quarter of the country's personal financial assets.



While Mr Koizumi and his advisers try to liberate those savings, the LDP conservatives will do all they can to preserve the system's hidden subsidies and cross-guarantees. Many of Japan Post's 271,000 civil servants, who form a crucial block of support for the LDP's old guard, will lose their jobs if Japan Post is broken up and forced to compete. And if the savings and insurance assets are freed to chase the best returns on capital, they are highly unlikely to end up paying for concrete river-beds and other public works in LDP constituencies. Nor are many politicians and postal-ministry bureaucrats eager to give the public a clear view of where all that money has been going over the years.

Masaharu Ikuta, a former shipping executive who became Japan Post's boss last year, has proved very useful to the conservatives even though Mr Koizumi nominated him for the job. Mr Ikuta, who has a collection of toy mail lorries from around the world in his office, is keen to expand and boost efficiency, but wants to avoid breaking up the company. He recently declared that it would take years to separate the computer systems that administer the savings and insurance schemes.

Market-friendly reformists, and Mr Ikuta's future competitors, have a long list of worries. First, they point to the mail delivery business, which still appears woefully inefficient. They have warned Mr Koizumi not to let Japan Post expand into new aspects of delivery, such as international logistics, until it has been fully cut off from the financial accounts. A huge, inefficient and heavily subsidised competitor could wreak havoc on the distribution industry.

Privatising the savings and insurance schemes is also fraught with peril. They enjoy tax breaks; and because they enjoy government backing are exempt from paying into industry-wide schemes that protect some savings deposits and life policies. At the very least, say rival banks and insurers, these supports must go before Japan Post is allowed to broaden its activities in financial services. Rivals also complain that Japan Post is overseen by the post, telecoms and home affairs ministry, whereas other financial institutions are regulated by the Financial Services Agency. Bankers argue that Japan Post has no expertise in credit assessment or risk management, and will make ill-advised loans as soon as it is given the chance. Insurers do not want poorly trained and lightly regulated civil servants competing with them to sell policies to Japanese housewives.

Foreign insurance companies are especially worried about unfair competition. The brunt of Kampo's subsidies have so far been felt in the domestic life-insurance sector. While Kampo maintained unrealistically high, government-backed rates on its policies, domestic life insurers could not compete. Under the added burden of taxes and payments to the industry-wide insurance scheme, one domestic insurer after another buckled in the 1990s. Now the foreigners fear similar pressure. If Kampo's existing policies, for example, are not hived off into a separate entity, it will be able to use revenues from them to finance an expansion into new insurance lines, such as policies for long-term health care, in which foreigners have done well.

Mr Koizumi and his advisers have been pushing for a scheme to deal with these fears. They want all existing savings and insurance accounts to be separated, with the newly liberalised entities competing from a fresh slate. They also want Japan Post's savings and insurance businesses to pay taxes and

deposit insurance on the same basis as rivals, and to remove government guarantees for their products.

Perhaps the thorniest issue is how closely, and for how long, Japan Post's four bits will remain connected to one another. Besides delivery, savings and insurance, there is a network of 24,700 post offices. Should there be a holding company with four subsidiaries at the start of the privatisation process, for example, or should Japan Post carry on for a while as one big integrated firm?

Whether the prime minister gets his way is an important test of how far reform will go. His idea is that privatised post-office outlets would be free to take mail, offer financial products and provide retail services, but would have to treat the other three Japan Post units as arm's-length suppliers, and would have incentives to sell rival products—such as mutual funds and other accounts from private institutions—over the counter.

Japan Post's defenders are urging the government to continue subsidising the post-office network, so that it can keep serving far-flung bits of the country. Mr Koizumi will surely have to give ground on this issue. But that is all the more reason to ensure that the savings and insurance units do not continue to enjoy subsidies too. It is time they fended for themselves.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Apology: Temasek

Sep 1st 2004
From The Economist print edition

1. In the August 14th-20th 2004 edition of *The Economist*, we published an article ("the Article") entitled "Temasek, First Singapore, next the world".

2. We recognise that the Article meant or was understood to mean that:

(a) Mr Lee Hsien Loong had appointed, or was instrumental in appointing, his wife, Mdm Ho Ching to Temasek Holdings Ltd, not on merit, but for corrupt nepotist motives for the advancement of the Lee family's interests; and

(b) Mr Lee Kuan Yew supported or condoned Mdm Ho's appointment for like motives.

3. We admit and acknowledge that these allegations are false and completely without foundation. We unreservedly apologise to Prime Minister Lee Hsien Loong and Minister Mentor Lee Kuan Yew for the distress and embarrassment caused to them by these allegations. We undertake not to make further allegations to the same or similar effect.

4. We have agreed to pay Prime Minister Lee Hsien Loong and Minister Mentor Lee Kuan Yew damages by way of compensation, and to indemnify them for all the costs and expenses incurred by them in connection with this matter.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The battle for UFJ

Deals on wheels

Sep 2nd 2004 | TOKYO
From The Economist print edition

What a tiny M&A outfit can teach the world's soon-to-be-biggest bank

FOR some Japanese firms, acquiring another company may soon be a little like getting a pizza delivered. On September 1st, Strike, a Japanese consulting firm that advises on mergers and acquisitions (M&A), launched a new service to help clients put a price on potential deals. Strike promises a speedy response. It will deliver your calculation within a week, or you get it for half price. Clearly, the service is aimed at small firms and internet start-ups. In big Japanese mergers, such as the proposed tie-up of UFJ Holdings and Mitsubishi Tokyo Financial Group (MTFG), the last thing managers want is a timely assessment of a deal's true value.

Indeed, despite a victory in the Supreme Court on August 30th, the two banks face all sorts of problems following last week's premature knock on the door from Sumitomo Mitsui Financial Group (SMFG), a rival suitor that had the temerity to say publicly how much it thinks UFJ is worth. By the traditional rules of Japanese M&A, UFJ and MTFG would be clear to join forces following the court decision, which will let UFJ out of an earlier pledge to sell its trust unit to Sumitomo Trust & Banking. The old rules are under strain, however, as foreign investors acquire bigger minority stakes in Japanese firms. Nearly one-third of UFJ's shares are owned by foreigners, who are keen to learn whether the bank will merge with MTFG on favourable terms.

SMFG's ¥3.2 trillion ($29 billion) offer, which values UFJ's shares at a 23% premium, has made it harder for UFJ's managers to stall. SMFG may soon stir up more trouble. Now that its merger proposal has gone nowhere, it is rumoured to be working on another offer, this time hostile, to purchase a majority of UFJ's shares. The last thing UFJ's managers want to worry about now is their shareholders' sensitivities. Their bank is under-capitalised and saddled with bad loans, and it needs an injection of capital before it closes its mid-year accounts on September 30th. If UFJ were to switch partners now, or to pause to entertain rival offers, it would be hard pressed to thrash out a deal before this deadline.

SMFG's president, Yoshifumi Nishikawa, no doubt realises this. But he can still make life difficult for the other two banks by lobbing in unwelcome bids and unsettling their shareholders. They may have to disclose the terms of their agreement to get SMFG off their backs. Perhaps Strike should consider an alternative service for the likes of UFJ and MTFG: a valuation that is guaranteed to arrive too late, or your money back.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Trade politics

Byrd-brained

Sep 2nd 2004
From The Economist print edition

America's Congress runs afoul of the World Trade Organisation, again

IT HAS been a rough summer at the World Trade Organisation (WTO) for America's trade officials. Recently the arbiter of global trade rules has ruled against them in cases from cotton subsidies to Canadian lumber. Now the Geneva body has also meted out punishment. On August 31st, a WTO arbitration panel ruled that eight of the organisation's members, including the European Union, could impose tariffs of up to $150m a year on American goods, because America had failed to repeal a law that the WTO first deemed illegal in 2002.

This law, known as the Byrd amendment after its sponsoring senator, is one of the most outrageous weapons in America's trade-protection arsenal. Passed by Congress in October 2000, it says that companies that initiate anti-dumping and anti-subsidy complaints should receive the proceeds of any duties that are imposed. It thus offers American firms a cash incentive to clamour for protection.

America's trading partners were outraged and filed a WTO complaint in 2001. The WTO decided that the Byrd amendment broke global trade rules, because it compensated American firms twice (in tariffs and money). America was given until December 2003 to get rid of the law. Nothing happened. Now the WTO says that the EU and others may impose tariffs worth up to 72% of the amount paid under the amendment to American companies.

This will not happen overnight. The EU, Japan and other plaintiffs have all played down the prospect of imminent retaliation. They say that they do not want sanctions but an end to the Byrd amendment. Unfortunately, that is highly unlikely. Although the Bush administration would like to comply, this is an election year. For his part, John Kerry has been complaining that the Bush trade team has failed to fight hard enough for American workers.

Even if the Bush team were willing, it would get nowhere in Congress, where the Byrd amendment is extremely popular. Last year 70 senators sent President Bush a letter saying he should leave the law alone. Its beneficiaries, such as steel and lumber producers, have effective lobbyists in Washington and much to lose from repeal. In 2000-03, over $700m was distributed under the Byrd law. According to the Congressional Budget Office, $2.35 billion could be dished out in 2005-09.

Any retaliatory tariffs, in contrast, will take a while to cause political pain. Not all countries subject to American anti-dumping duties (and thus the Byrd law) joined the WTO complaint. China, a regular target, was not party to it and so cannot hit back under this week's ruling. If the EU and others eventually impose tariffs, these will not hit the main beneficiaries of the Byrd amendment but a different group of exporters, who will need time to convert legislators to the cause of repeal. Gary Hufbauer, a trade expert at the Institute for International Economics, thinks the earliest likely date for repeal is 2006.

Congress's performance on tax breaks for “foreign sales corporations”—in essence, export subsidies also deemed illegal by the WTO—hardly signifies respect for global trade rules. In March 2004, the EU imposed tariffs on American goods, in WTO-sanctioned retaliation. These tariffs are being raised by one percentage point a month. Congress's efforts to remove the subsidy have morphed into a monstrous corporate-tax bill, stuffed with giveaways for everyone from tobacco companies to bourbon distillers, that would do more harm than the tariffs. In any case, its prospects for passage, at least before the election, are slim.

As these episodes show, the ingredients for rising trade tension and anti-WTO sentiment in Congress are present. It is a pity that, while America's lawmakers squeal about the importance of fair rules for global trade, they are reluctant to accept the WTO as a judge of what is fair and what is not.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Long-Term Capital Management

Taxing the ghost

Sep 2nd 2004
From The Economist print edition

The IRS nails a dead hedge fund

EVEN in death, the world's most notorious hedge fund cannot escape the taxman. On August 27th a federal judge in Connecticut ruled that Long-Term Capital Management (LTCM), which blew up spectacularly in 1998 despite having two Nobel economics laureates among its founders, had created meaningless tax shelters in order to report a $106m loss in 1997. Instead, the fund should have paid $40m to the Internal Revenue Service (IRS). With penalties, the sum is likely to reach $56m. The bill will go to the 12 former partners. An appeal seems likely, although some of the money has already been paid.

LTCM's reputation can hardly sink further. During the mid-1990s the fund stood at the forefront of the hedge-fund boom. Fronted by the Nobel luminaries, Myron Scholes and Robert Merton, and John Meriwether, a formidable trader, it made galloping returns by wagering billions in mostly borrowed money. Its debt-equity ratio reached 50:1. Then Russia's financial crisis hit. The spreads between LTCM's supposedly market-neutral bets widened. Fearful that the fund would destabilise financial markets if it went bankrupt, the Federal Reserve prodded bankers into a $3.65 billion bail-out.

Six years on, hedge-fund sceptics cite the demise of LTCM as prime evidence of the need to regulate the sector. Now its elaborate tax schemes are also the stuff of a cautionary tale. LTCM used nine complicated cross-border transactions to claim tax relief. Essentially, the court found, it employed an entity incorporated in the Turks and Caicos Islands to exploit tax advantages derived from the leasing of equipment. Four of the transactions, for example, involved Wal-Mart trucks.

The judge found that LTCM's arrangements “lacked economic substance and should therefore be disregarded for federal tax purposes”. Joseph Stiglitz, another Nobel economics laureate, was the government's star witness. According to the court record, he testified that a rational actor would not have chosen LTCM's route without tax benefits. Mr Scholes, who helped design the shelter, also helped the government case, but unintentionally. In 1996 he asked in a memorandum: “How should LTCM pay those who brought the tax losses to fruition?”

LTCM is not alone. This was the IRS's sixth victory in a year against what it calls “abusive tax shelters”. Michael Knoll, a law professor at the University of Pennsylvania, says that aggressive tax schemes have proliferated in the past decade. Often, accounting firms draw them up, helped by law firms and investment banks. The market for them, says Mr Knoll, is vast. But the IRS is getting fiercer. It is also working with the Department of Justice to crack down on firms that design the shelters. Another initiative, announced last May, offered a settlement to those using a shelter known as “Son of BOSS” (short for bond and options sales strategies); more than 1,500 taxpayers signed by the June deadline.

Last week's ruling will worry lawyers too. Companies often reckon that if lawyers sign off on their offshore transactions, they should be in the clear. LTCM had obtained such opinions from two law firms. The judge took a different view.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

American banks

Smart liquidation

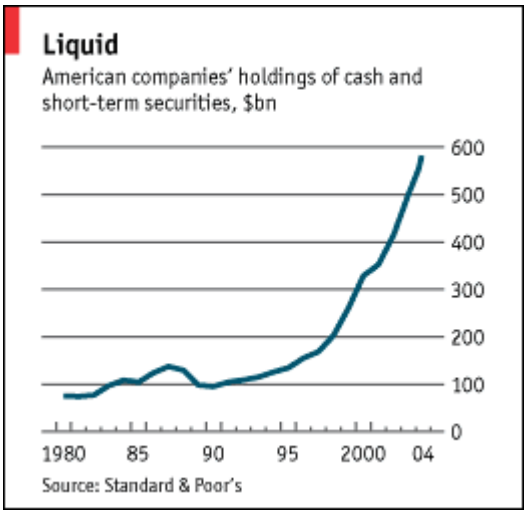
Sep 2nd 2004 | NEW YORK
From The Economist print edition

Flush with capital and facing low returns, American banks shed capital

SELDOM have America's commercial banks been more adept at using money to make money. Their total earnings this year will almost certainly top $100 billion, a record. Returns on equity are healthily in the mid-teens. Regulators consider 99% of domestic banks to be well-capitalised, also a record. Banks are thus both safer and more profitable, a fine combination.

In the past, banks would have ways of undoing this good work, through costly acquisitions or headstrong expansion into marginal businesses. This time, there is reason to hope for better, says Charles Bralver, head of the North American practice of Mercer Oliver Wyman, a consultancy. The greatest check is the growing intolerance of the financial markets. Since share prices last peaked in 2000, the range of banks' price-earnings ratios has narrowed. This suggests, he says, that valuation is now based more on proven results than on speculation about future growth.

The markets' caution makes sense. Companies are holding record amounts of cash (see chart). Their demand for loans is correspondingly low, and with margins thin banks are unlikely to make much profit by trying to boost lending.



As for mergers, Mr Bralver says banks have become acutely conscious of the stockmarket's scepticism about costly deals. If an acquirer pays a 20% premium, which is not uncommon, it faces hostile shareholders. Pay over 30%, and the deal must look remarkably good or its share price will plummet. Pay 40%, as Bank of America did for FleetBoston Financial last year, and almost nothing will suffice. Although the deal allowed Bank of America to build the country's first truly national bank, a year later its shares trade at the bottom of the range for big banks. Its price-earnings ratio is 20% below Citigroup's and 40% less than that of BB&T, Bank of America's North Carolina neighbour.

At the same time, banks have become more sophisticated and careful in their use of capital, at any rate in lending. Loans are increasingly sold to institutional investors. Generally, they are far better capitalised than regulators require. As a result, banks may slowly be coming to the conclusion that they are over-capitalised.

This, combined with a change in tax law last year that favoured dividends, seems to have started a flood of payments to shareholders. In the past year a lot of banks have increased their dividends, many dramatically, including Citigroup (by 75%), Fifth Third Bancorp, Mellon Financial, National City, State Street and Wachovia. Washington Mutual has done it three times. According to Standard & Poor's, the share of profits paid out as dividends by large banks rose from 30% in 2002 to 35% last year, the top of its normal range. Some banks, including Wachovia, plan to push the payout ratio higher. Mr Bralver believes that the dispersal of capital, either through dividends or repurchases of shares, will only increase over the next six to 12 months as all but the most highly valued banks pare back to sustain high returns on retained capital.

As with other companies, if banks cannot use shareholders' money sufficiently profitably, it makes sense to pay higher dividends. Granted, it might prove costly for some customers if banks lend less. But better use and pricing of capital should help the economy as a whole: there should be less reckless lending and therefore less chance of bubbles and consequent crises.

Higher dividends may also be an indication of a sea change in American banking. Dividends have been high before, several years ago, when competition for deposits was limited by regulation. Once competition increased and consolidation and innovation became widespread, dividends were restrained as banks invested heavily in their own growth. Now, with yields up and growth prospects down, the process, says Mr Bralver, may have come full circle.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Outsourcing to India

Safety matters

Sep 2nd 2004 | DELHI
From The Economist print edition

An outbreak of data protectionism?

FIRST they steal our jobs, then our credit-card numbers. Those seem to be the fears inspired by outsourcing back-office financial-services work to India. In both Europe and America, the argument that outsourcing costs jobs at home still has political resonance. But it is making way for another bogey: that India cannot offer the standards of privacy and data protection that consumers expect at home. Outsourcing is dangerous and perhaps even illegal. Both claims seem dubious.

They have come together in a complaint to Britain's information commissioner, the data-protection watchdog, by a customer of Lloyds TSB, a big British bank. The bank is accused of breaking the law by failing to secure its customers' explicit consent before sending personal information outside Europe.

Like many banks, Lloyds has shifted some operations to India. It has a back-office processing centre in Bangalore, and a call-centre in Mumbai. As a result, last October it announced it would be closing a call-centre in Newcastle, where 980 people were working. Lloyds insists it is “absolutely compliant” with data-protection legislation. It argues that, as the law stands, it does not need its customers' permission to export data provided it has ensured that the information is adequately protected.

Viewed from India, the case seems part of an ominous trend: a new front in a guerrilla campaign against the globalisation of white-collar work. Gartner, a consultancy, has forecast that security and privacy concerns will replace job losses as the top “backlash issue”. Nearly 200 pieces of legislation intended to limit outsourcing are at various stages in America's Congress and most of the country's state legislatures. Dozens of them involve restrictions on the transfer of personal data.

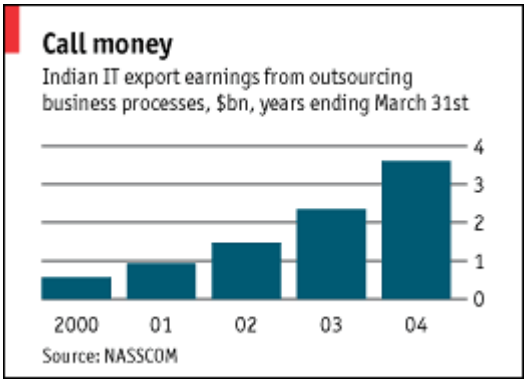
The Indian industry is already building its defences. NASSCOM, its national lobby, is conducting an audit of its members' security. It has also proposed a tightening of India's own information-technology act. But the top Indian firms argue that their procedures are already world-class. ICICI OneSource, for example, the outsourcing arm of India's largest private-sector bank, and Lloyds' service-provider, claims that its security standards are “much more stringent” than those followed by firms in Europe or America.

It has strenuous physical security measures protecting its computer terminals, as well as elaborate software to guard against hackers and viruses. In most cases, it says, personal data such as credit-card numbers, names and addresses do not even pass through its systems, remaining on its clients' database servers. Importantly, in an industry where job-hopping is endemic, it also says it is careful about the background checks it carries out on new employees.

Given the amount of outsourcing to India, there have been remarkably few security scandals. In a much-publicised case last year, a woman in Pakistan, working remotely for a medical centre in California, threatened to post confidential patient records on the internet if she was not given a pay rise. (The whole point of Pakistan, of course, is that it is not India. But it is close enough to worry some.) This year Wipro Spectramind, an Indian call-centre firm, caught some of its workers making unauthorised offers in phone calls marketing services for its client, Capital One, an American financial-services firm.

In the areas of biggest concern to banks and their customers, however—credit-card fraud and identity theft—there have been few reported incidents, and these have been small. At ICICI OneSource, for example, Raju Bhatnagar, the chief operating officer, says that there have only been two incidents of credit-card abuse, involving the theft of, respectively, $13 and $22.

Inevitably, there will be bad news. As Simmi Singh of Cognizant, another big outsourcing firm, points out, “crime rises in proportion to volume”, and this is a fast-growing industry (see chart). Moreover, even if security concerns are a cloak for protectionism, they are real enough for banks' customers. Just as many people who happily surrender a credit card to an unknown waiter are reluctant to enter its details on an encrypted website, so many will find it hard to believe that their data are no more at risk in Mumbai than in Newcastle. This is a new frontier where, as Ms Singh puts it “cyberspace meets globalisation”; and, for some people, it's pretty scary.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Fuel-oil futures in China

Step by step

Sep 2nd 2004
From The Economist print edition

China's cautious approach to liberalising derivatives trading

AP

Still unrefined

ON AUGUST 25th, Chinese traders found themselves at the fountainhead of innovation. The Shanghai Futures Exchange became the first in Asia to trade fuel-oil futures. In a way, it was no surprise. Last year, China consumed 43m tonnes of the grimy stuff that drives tankers and electricity generators, or one out of every 12 barrels in the world. Its imports rose by 40% in the year to July. As prices have risen, the need for hedging by power producers and others has become critical. The country's top securities regulator proclaimed that this was the first step towards introducing crude-oil derivatives.

In fact, China has had trading of fuel-oil futures before. But in 1994, the authorities shut it down because of widespread “speculation.” They have pledged not to let it happen again. Short-selling will be banned. Dealing will be stopped if prices fluctuate too much, and traders are required to maintain much higher reserve requirements than for other commodities. Further, they must have the stuff on hand.

The restrictions are a fine example of liberalisation, Chinese-style. The same day that the futures market was launched, the government raised the cap on retail petrol prices for the first time in three months, by 6%, to 3.42 yuan ($0.41) per litre. This made sense: rising oil prices put a squeeze on two large refiners, Sinopec and PetroChina, which can now pass on some of their higher costs. However, crude prices had risen much faster in the same period, hitting a record high. There is no talk of removing the cap. Meanwhile, the New York-traded stocks of both companies have shed a fifth of their value since the start of the year.

At least the moves are in the right direction. In January, import quotas on fuel oil were eliminated and in June, cotton futures were introduced. Trade in several other commodity futures is brisk.

The elephant in the room, though, is China's currency, the yuan. In June the Chicago Mercantile Exchange signed a deal to provide the Chinese with “advice...in the development of foreign-exchange derivatives.” Does this mean the yuan will soon be unpegged? Unlikely: Chinese officials have long said that they will make it convertible, but have never set a date. “Everyone agrees that, ultimately, the currency will need to be more flexible,” says Tai Hui, an economist at Standard Chartered Bank in Hong Kong. He put the stress on the adverb.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economics focus

A future meltdown?

Sep 2nd 2004
From The Economist print edition

The ageing of the baby-boomers casts doubt over asset prices, too

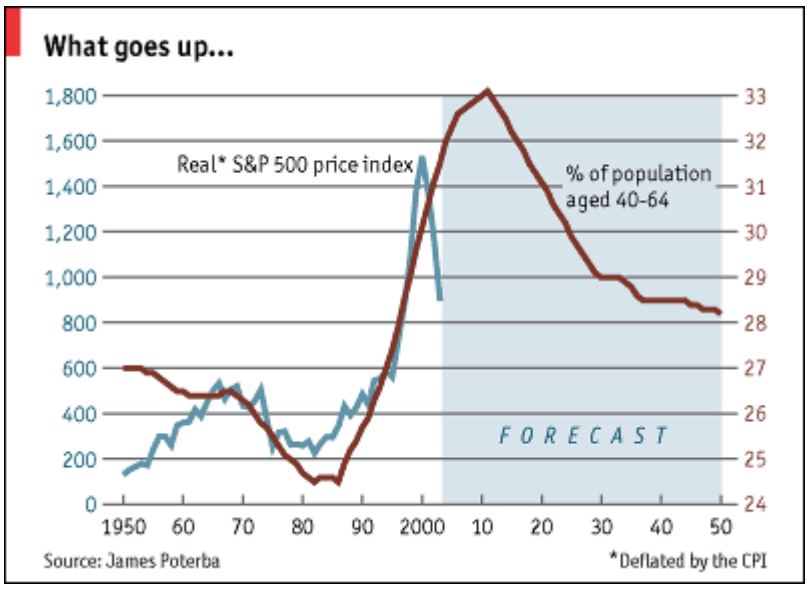
IN TODAY'S electronic age is it really worth travelling 17 hours from London to attend an economics conference? If that conference is the annual symposium of the Federal Reserve Bank of Kansas City, held in Jackson Hole, Wyoming, at the base of the majestic Grand Tetons, and attended by central bankers and economists from around the world, the answer is definitely yes.

The topic of this year's symposium was the future economic impact of ageing populations. The papers presented went much further than the well-known implications of ageing for labour-force growth and public finances, and focused more on its effects on future economic growth rates, the return on capital, interest rates and exchange rates. One of the most interesting papers* was by James Poterba, an economist at the Massachusetts Institute of Technology, who explored how demographic change might affect financial markets.

As a result of declining birth rates and longer life expectancy, rich countries will in future have more old people and fewer young. In addition, as the baby-boomers retire, the ranks of the middle-aged will also dwindle. Between 2000 and 2050 the share of America's population over the age of 65 will grow from 12% to 21%, while the share of the population aged 40-64 will fall from a peak of 33% in 2010 to 28% by 2040. In Japan and some European countries, the shift will be even more dramatic.

The significance of this change is that people tend to save most, and to accumulate financial assets, during middle age. According to the standard “life-cycle” theory, people vary their saving rate over their lives in order to smooth consumption. When young, people borrow, to spend more than they earn; in middle age, they repay their debts and build up a nest egg for retirement; when old, they sell assets to finance their retirement. This suggests that changes in the age structure of the population will affect total saving in the economy and thus asset prices.

During the past 40 years the real level of the S&P 500 has indeed moved broadly in line with the share of the adult population aged between 40 and 64, allowing for occasional bubbles and busts (see chart). Thus in the 1990s, as the baby-boom generation reached their prime working years and their time of greatest asset accumulation, share prices soared. The worrying implication is that when this group starts to retire after 2010, share prices will fall as they become net sellers of assets to the next, less numerous generation of investors.



To explore the risk to future asset prices, Mr Poterba analysed the relationship between America's changing demographic structure and the level of asset prices in more detail between 1926 and 2003. He finds a positive correlation between the level of share prices and the share of the population aged between 40 and 64. The result is, however, highly sensitive to the exact specification of the model used to control for other factors.

So will share prices fall in future as the baby-boomers age? One flaw in this theory, Mr Poterba points out, is that detailed savings data suggest that, while older people stop accumulating further net wealth, they do not run down their assets as fast as the life-cycle theory implies. Because they do not know when they will die, or because they want to leave something for their children, retired people reduce their assets only gradually, in order to ensure they have sufficient capital to live on or to pass on to their heirs. As a result, there may be no sudden rush to sell assets when baby-boomers retire.

Another reason for thinking that any fall in share prices will be more modest than crude models suggest is that it is common knowledge that the baby-boomers are nearing retirement, so market prices today should already be taking account of future demographic developments. Share prices should therefore adjust relatively smoothly over time, thereby avoiding a meltdown. A third moderating effect is that the market for capital is global. Because savers can invest abroad in foreign assets, the link between an ageing population and domestic share prices will be muted.

Wobbly foundations

One area not addressed by Mr Poterba is the housing market, on which ageing could have a bigger effect than on share prices. After all, homebuyers are generally not professional investors, and are therefore less likely than equity investors to take account of falling future demand in the prices they pay today. Moreover, whereas in the past most homeowners tended to live in the family home throughout retirement and then leave it to their children, a house purchase is now increasingly viewed as an investment which can be used to finance one's old age, either by trading down to a smaller home or by selling a “buy-to-let” property. According to a survey by Mintel, a market-research firm, two-fifths of Britons think that investing in bricks and mortar is now the best way to save for retirement. In other words, they may be buying property with the very aim of selling when they give up work. If the baby-boomers all try to sell at the same time, and there are fewer buyers, then house prices could slide.

However, using demographic forecasts to predict house prices is a dangerous game. In 1988, a widely publicised study by Gregory Mankiw, now chairman of President George Bush's Council of Economic Advisers, and David Weil, of Harvard University, predicted that American home prices could fall by 47% in real terms by 2007. Their reasoning was that, as the smaller “baby bust” generation entered its house-buying years, demand for residential property would grow more slowly in the 1990s than at any time in the previous 40 years. Instead, since the mid-1990s America has seen its biggest-ever rise in real house prices, buoyed by strong immigration, cheap money—and the unrealistic expectation that property prices will soar for ever.

* “Population Aging and Financial Markets”. Available at www.kansascityfed.org/publicat/sympos/2004/pdf/Poterba.Paper.0810.pdf

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Reproductive health

Ten years' hard labour

Sep 2nd 2004 | ADDIS ABABA AND LONDON
From The Economist print edition

Panos

More money and less ideology could improve the reproductive health of millions

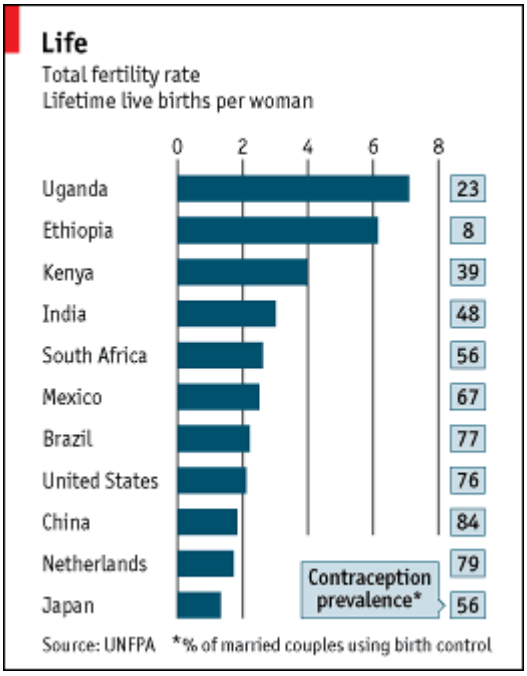
A DECADE ago, the world's leaders met in Cairo at the International Conference on Population and Development (ICPD). There, they crafted a plan to achieve “reproductive health and rights for all” by 2015. That plan was wide-ranging—from more contraception and fewer maternal deaths to better education for girls and greater equality for women. But more than just setting targets, the ICPD plan also aimed to change the way those at the sharp end of making policy and delivering services thought about reproduction. It wanted to move away from a focus on family planning (and, by extension, government policies on population control) towards a broader view of sexual health, and systems and services shaped by individual needs.

Over the past week, hundreds of government officials, public-health experts and activists met in London to mark the anniversary of the ICPD and to take stock of progress towards achieving its goals. On paper, that progress has been impressive. Governments around the world have introduced legislation that reflects the ICPD's aims. But when it comes to turning policy into practice, “mixed success” is the verdict of a report card just released by Countdown 2015, a coalition of voluntary bodies involved in the field.

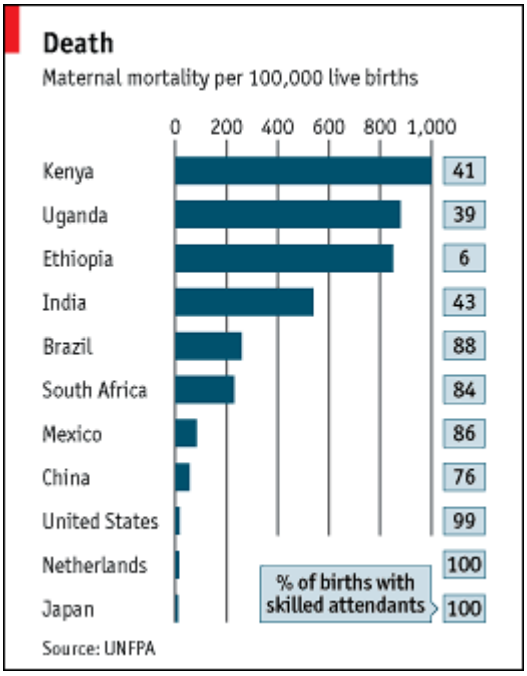
Take contraception, for example. According to the United Nations' Population Fund (UNFPA), 61% of married couples now use contraception, an 11% increase since 1994. This has helped push global population growth down from 82m to 76m people a year over the past decade. But in some places—particularly in sub-Saharan Africa and parts of Asia—birth rates remain high (see chart). That has spurred some governments to offer incentives to those who have fewer children, and others to inflict penalties on those who do not.

Sometimes, a high birth rate is a result of people wanting large families. But often it is due to a lack of affordable contraception. UNFPA estimates that 137m women who want to use contraception cannot obtain it. As Amare Bedada, the head of the Family Guidance Association of Ethiopia, points out, “We don't

need to tell our clients about contraception. They see their plots of land diminishing, and they tell us they want to limit their family size."



Maternal health is another area where much more needs to be done. Poor women still die in huge numbers from the complications of pregnancy and childbirth. According to UNFPA, 920 women die for every 100,000 live births in sub-Saharan Africa. In Europe, by contrast, the figure is 24 (see chart). However, these numbers are, at best, only rough estimates gleaned from hospital statistics. Many women go uncounted because they never reach the health-care system for treatment in the first place.



Plenty of studies have shown what it takes to reduce maternal sickness and death. Good ante-natal health care is vital. So are cheap and simple drugs, such as oxytocin, to prevent haemorrhaging during birth. Trained midwives (or "birth attendants" as they are known in medical parlance) help, too. And so do local emergency obstetric centres that can handle complicated deliveries. Some countries, such as Sri Lanka, have managed to cut maternal mortality by careful spending on such measures. The challenge is to translate these successes to other places.

Yet another subject that needs to be tackled more effectively is youth sex. The largest generation of teenagers in history—a whopping 1.3 billion 10-19-year-olds—is now making its sexual debut. How it behaves, and what it learns, is crucial.

The ICPD plan was the first international agreement to acknowledge the sexual and reproductive rights of teenagers. A few countries, such as Panama, have introduced laws to safeguard some of these. In many others, youth-friendly programmes have sprung up to offer advice and assistance on thorny issues such as unwanted pregnancy and sexually transmitted diseases—now soaring worldwide at 340m infections a year.

Such programmes, of course, are complicated by fierce—if probably futile—battles in many countries over whether young people should be having sex at all. These play out in international skirmishes over abstinence versus condoms for the young, parental consent to contraception and abortion, and what, if any, sex education should be provided by the state.

Sex and money

One significant obstacle to tackling these problems is money, or rather the lack of it. Ten years ago, the ICPD estimated the cost of implementing its recommended programmes at $18.5 billion by 2005—or $23.7 billion in today's dollars. The goal was to mobilise one-third of that money from rich donors, and the rest from developing countries themselves. But current spending is well below the mark.

Few poor countries have earmarked enough of their budgets to meet their citizens' reproductive-health needs. Nor have donors lived up to expectations. In 2003, they spent an estimated $3.1 billion on

reproductive health. Although contributions have increased over recent years, with a few European countries, such as the Netherlands, chipping in more, and private donors, such as the Gates Foundation, entering the field, this is still far off even the inflation-devalued $6.1 billion expected from donors by 2005.

Reproduction, it seems, is no longer a sexy subject. As Steve Sinding, the head of the International Planned Parenthood Federation (IPPF), points out, donor interest in the past was stimulated largely by fears of a population crisis. When the Cairo Conference reframed the issues in terms of women's health and reproductive rights, that demographic rationale was lost, taking funding with it.

Moreover, there are other causes competing for international funding, most notably AIDS. At the time of the Cairo Conference, 20m people were infected with HIV, the virus that causes AIDS. Today, that number has doubled. Indeed, AIDS threatens to derail the ICPD strategy. For, although billions of dollars are now pouring in to fight the disease, much of this money is going into AIDS-specific programmes that do not address reproductive health more broadly.

As Nafis Sadik, a former head of UNFPA and now the UN secretary-general's special envoy for HIV in Asia, observes, ten years ago those working in family planning shied away from the field of HIV, with its heavy burden of social stigma. Today, the roles are reversed, as reproductive health is engulfed in a storm of religious and political controversy. One consequence is that organisations concerned with fighting AIDS are failing to make use of valuable infrastructure and expertise already on the ground in places where the disease hits hardest. Given that more than half of HIV infections in sub-Saharan Africa are among women, and that for many African women family-planning services are their main contact with the formal health-care system, such services need to be drafted into the wider battle against HIV. Many family-planning clinics already offer HIV testing and counselling, as well as condoms (against the double whammy of unwanted pregnancy and HIV infection), and also a broad based message of sexual health.

What the field of reproductive health lacks in resources, however, it makes up in ideology. Over the past ten years, battles have broken out between contending views of sexuality, pitting religious conservatives—*primus inter pares*, the Vatican—against social liberals. The fight has become particularly fierce since the election of George W. Bush as America's president. Mr Bush's socially conservative views are reflected in the way America, the world's leading donor for reproductive health, spends its money at home and abroad.

Breeding trouble

The main battles are over abortion. Austin Ruse, the president of the Catholic Family and Human Rights Institute (C-FAM), an American Christian lobby group, argues that the shift in talk from fertility control to reproductive rights and services is just code for making abortion universally available. He regards this as wrong, and believes that the ICPD plan of action and those agencies which support it—particularly UNFPA—should be opposed at every turn by a growing coalition of “pro-family” groups worldwide. “Over the next five years, I see everything coming our way, especially on the question of abortion,” says Mr Ruse.

UNFPA, not surprisingly, has a different view. Thoraya Obaid, its head, reckons that those who oppose the ICPD plan of action are not just against legalising abortion, but are fighting against women's rights in general. She points to the text of the plan, which states that abortion should never be promoted as a form of family planning and that women should be helped to avoid abortion through better access to contraception. (It also says that those who have sought abortions are entitled to the best possible medical treatment to deal with the complications.)

All sound stuff, but trouble lies in the plan's statement that abortion policy should be up to national governments to decide. Since 1994, more than a dozen countries have liberalised their laws on abortion (with a couple of countries tightening them up). But none of this comes without a fight, often led by the Catholic Church. Kenya has seen a particularly nasty debate over the past six months. There have been street protests, graphic television “docudramas” showing the perils of abortion, and even the arrests of health-care workers who are alleged to have performed more than a dozen abortions whose fetuses recently ended up in a ditch outside Nairobi. The government, which was looking at its abortion laws as part of a broader constitutional review, has made no changes to the current provision, which bans abortion unless the mother's life is at stake.

In many developing countries, Christian anti-abortion groups such as America's Human Life International—a sister organisation to C-FAM—have been pitching in to help organise resistance to changes in abortion laws. But American officials have entered the fray as well. Delegates to regional meetings held in Latin America during the past year to re-affirm their commitment to the ICPD plan of action have complained about pressure from American officials to reject the plan's calls for broad-based reproductive rights and services.

While pressure by the Catholic Church and other opponents of legal abortion can shape official policy, Tim Black, the head of Marie Stopes International (MSI), a voluntary organisation providing reproductive services, argues it does little to stop women seeking abortions, legal or illegal. Surveys from hospitals in Ethiopia, Uganda and Kenya suggest that anywhere from 20-50% of maternal deaths are due to complications resulting from unsafe backstreet abortions. But these numbers are challenged by the opponents of abortion, who argue that it is a rare phenomenon in the developing world, and that legalising it will make it more common.

The American government's views on abortion are expressed in the Mexico City Policy, which was re-introduced by Mr Bush in 2001. This policy, first implemented by Ronald Reagan in 1984, forbids American government funding of foreign organisations which in any way promote, endorse or advocate abortion. American law has banned foreign assistance for the direct performance of abortions since 1973. But the Mexico City Policy, or “Global Gag Rule” as its critics often refer to it, means that groups which want to perform abortions with money from other sources must also toe the United States' line, or else forfeit American assistance.

Opponents of this policy argue that it imposes on foreigners restrictions which are unconstitutional in America. Indeed, Frances Kissling, the head of Catholics for a Free Choice, an American voluntary organisation which opposes banning abortion, argues that Mr Bush is flexing his conservative muscles abroad—and therefore appeasing his supporters at home—precisely because he cannot deliver a domestic anti-abortion agenda. Last week, for example, a court in New York declared unconstitutional a ban on so-called partial-birth abortion that Mr Bush signed into law in 2003.

Several prominent family-planning organisations, such as MSI and the IPPF, have refused to agree to the Mexico City Policy, saying it compromises their ability to offer women in poor countries the full range of services available in the rich world. In Ethiopia, for example, these groups have had to trim their services and shelve expansion plans as a result of losing both money and contraceptive supplies from the American government.

Such arguments, however, cut little ice with Jeanne Head, the United Nations representative for National Right to Life, an American anti-abortion group. As she puts it, “if they refuse these funds and they can't keep functioning, then they don't care about these women, they only care about abortion. I think the blame lies on the organisations, not on the US government.”

John Kerry has said he will rescind the Mexico City Policy if elected. The Democratic candidate has also promised to restore American funding to UNFPA. This has been withheld by the Bush administration for the past three years under a piece of legislation called the Kemp-Kasten amendment. This amendment authorises the president to restrict funding to any group that “supports or participates in the management of a programme of coercive abortion or involuntary sterilisation.”

The White House accuses UNFPA of abetting coercive reproductive practices in China—a claim that UNFPA denies. Several international delegations, including ones from Britain's parliament and the American State Department, have investigated UNFPA's activities in China and failed to find evidence to support such allegations. On the contrary, they argue that where UNFPA operates, policies in China are improving. But these findings are contested. The Bush administration says UNFPA has yet to mend its ways, and refuses to pay the $34m appropriated by Congress. The agency says it has managed to fill the gap this year, from big donors such as Britain, which is raising its annual contribution to £20m ($36m), and tiny ones such as Afghanistan, which chipped in $100.

But making up the money is the easy part. Today's battles over abortion, abstinence and condoms are casting a pall over the field, and complicating what is already a formidable task. Making sex safer and reproduction less risky in the 21st century requires all the tools to hand. Policies that restrict people's choices should not be a fact of life.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Genital mutilation

The unkindest cut for a woman

Sep 2nd 2004 | CAIRO AND EJERE
From The Economist print edition

Slow progress in eliminating female genital mutilation

EPA

Unconscionable

IN SUDAN, they call it *tahoor* or "purification". In Sierra Leone, it is known as *bondo* or "initiation". But English has a grislier term for it: female genital mutilation. In its mildest form, a girl has the skin covering her clitoris nicked or excised. In the severest variety, called infibulation, her external genitalia are cut away and her vagina is sewn up.

Female mutilation is not a rare practice. Although numbers are hard to come by, an estimated 130m girls and women now alive are thought to have undergone the procedure in more than two dozen African countries, as well as in parts of Asia, the Middle East and some immigrant communities in the West. The frequency of it varies according to ethnic group and country, from a quarter of women in Nigeria to more than 90% in Mali, recent surveys indicate. The timing and type of mutilation also differs. In Egypt, for example, girls undergo one of the milder forms, usually around puberty. In Somalia, infibulation is common, often a few weeks before marriage.

There are certainly sound medical reasons for eliminating the practice. Immediate complications include heavy bleeding, infections—such as AIDS—transmitted by unsterile knives, and a nasty condition known as urinary retention. And, not only does mutilation turn sexual intercourse into a numb or painful experience for women, but the more radical forms can lead to prolonged labour and potentially lethal complications during childbirth.

The International Conference on Population and Development, held in Cairo ten years ago, launched a big push against mutilation. Since then, 13 African countries have passed legislation banning the practice. Education also helps, but simply explaining the medical hazards is not enough. At the time of the Cairo conference, as many as 97% of Egyptian women were thought to have been circumcised, usually by a *daya* (a village midwife). A decade of communication on the health risks of mutilation means that figure has fallen slightly, but the big shift is that the procedure is now performed mainly by doctors, which makes medical arguments against it less convincing to those who seek it out.

As Nahid Toubia, the head of Rainbo, a charity working against the practice, observes, stamping mutilation out is a slow process. Many societies believe that a woman will become agitated, overbearing, sexually voracious—and so unmarriageable—unless her clitoris is controlled. Or, as one woman in Ejere, a village in southern Ethiopia, explained, "I had my daughter circumcised so she wouldn't break the dishes."

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Shakespeare

Will o' the wisp

Sep 2nd 2004
From The Economist print edition

Ronald Grant

Revealing a man who might have been the world's greatest playwright

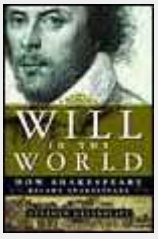
THERE is a secret despair in the prospect of reading yet another life of Shakespeare. Can anything more be squeezed from those few facts? Scholarly fastidiousness only compounds it: the sonnets, we are warned, are experiments in literary form, not autobiographical documents; the so-called “lost years”, through the sparsely recorded 1580s to 1592, are just that—lost. The theory that Shakespeare might have lived some of them dangerously, in the dissident Roman Catholic households of certain Lancashire magnates, is baseless—“far-fetched”, says Frank Kermode in “The Age of Shakespeare”, “as one ‘might have’ succeeds another, or a ‘may well have’ or a ‘surely’.”

Stephen Greenblatt's biography is a rich and exuberant antidote to such despair. Where he speculates he admits it, and goes ahead anyway. Mr Greenblatt is an eminent historicist, a critic who is alive to the author's historical context, to the mass of customs, beliefs and practices with which the creative imagination interacts. He has an appetite for the out of the way, for deletions in an old document, for minutes and judicial proceedings, for the technical meanings of words, for networks of friends and mentors. More than that—in a book intended for the general reader—he can make these things eloquent.

The Lancashire story may be wrong about where Shakespeare was when, but the known facts of it come close enough to him to be worth telling. In any case, Mr Greenblatt suggests nothing so transparent as that Shakespeare was a secret Roman Catholic. On the contrary, what interests him is the opacity of Shakespeare.

The chapter on “Hamlet” is a case in point. In a seductive display of learning and “may well haves”, Mr Greenblatt takes the unprecedented inwardness of that play, the obscurely motivated madness of its hero and its preoccupation with mortality, to arrive at something that might just be the man himself: William,

Will in the World: How Shakespeare Became Shakespeare
By Stephen Greenblatt



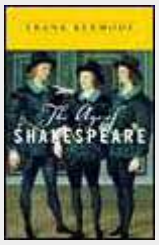
Norton; 434 pages; $26.95. To be published in Britain by Jonathan Cape in October

Buy it at
Amazon.com
Amazon.co.uk

The Age of Shakespeare
By Frank Kermode

with his son Hamnet (an alternative spelling) already in the ground and his (possibly) Catholic father (possibly) dying, finding himself uneasily balanced between the scant comfort of Protestantism and the outlawed doctrine of Purgatory, which linked the living, through prayer, with the dead. The method is pursued everywhere, but notably in chapters on “The Merchant of Venice”, “King Lear” and “Macbeth”, each of which unfolds events in Shakespeare's life and works them round to themes in the plays—always acknowledging the distance travelled, the absence as well as the presence of a real Shakespeare.

Or almost always. Sometimes Mr Greenblatt allows himself to trawl the plays for easy autobiographical pickings. For Shakespeare's hasty and ill-matched marriage, for example, he finds plenty on hasty and/or ill-matched marriages: “How could he have written Orsino's words [in ‘Twelfth Night']”, he asks, “without in some sense bringing his own life, his disappointment, frustration and loneliness, to bear upon them?” Given Shakespeare's range of empathy, a quote can probably be found for anything a critic might want to say about him.



Modern Library; 240 pages; $21.95.
Weidenfeld & Nicolson; £12.99

Buy it at
Amazon.com
Amazon.co.uk

Looking for Sex in Shakespeare
By Stanley Wells

Cambridge University Press; 122 pages; $15.99 and £10.99

Buy it at
Amazon.com
Amazon.co.uk

The play's the thing

In his book Mr Kermode is altogether cooler. “Sentimentality”, he writes, “has always been a nuisance in Shakespeare studies.” Where Mr Greenblatt elaborates, Mr Kermode encapsulates. He has no wish to get at the psychological roots of Shakespeare's creativity. He covers the biographical ground, but with caveats—Hamnet and Anne Hathaway flit past. The plays are Mr Kermode's thing, the patterns and rhythms of the words, the way these shape the mood. The penetrating insights of his earlier book, “Shakespeare's Language”, are reiterated here, but less expansively.

Mr Kermode notes a change during the period of Shakespeare's career from rhetorical acting on stage to a more personal style. Shakespeare, it is thought, could write as though Hamlet were thinking out loud because Richard Burbage, his tragedian, could act in that way.

Stanley Wells's “Looking for Sex in Shakespeare” wittily discusses the whole question of interpretation, critical and theatrical, the history of it and current practice. Actors and critics look for the subtext—and increasingly, since Freud, the sexual subtext. It is a part of Shakespeare's greatness that, as our culture changes, so more and different meanings become available. Does the author's intention matter, if the text yields readings he might not have recognised? What part does the audience play? Mr Wells has fun with certain “lewd interpreters”, and everywhere shows a sanity and openness of judgment that critics and actors should note.

Will in the World: How Shakespeare Became Shakespeare.
By Stephen Greenblatt.
Norton; 434 pages; $26.95.
To be published in Britain by Jonathan Cape in October

The Age of Shakespeare.
By Frank Kermode.
Modern Library; 240 pages; $21.95.
Weidenfeld & Nicolson; £12.99

Looking for Sex in Shakespeare.
By Stanley Wells.
Cambridge University Press; 122 pages; $15.99 and £10.99

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Christopher Marlowe

An imaginary life

Sep 2nd 2004
From The Economist print edition

Further light on the opaque world of Elizabethan literary genius

ONE of the pleasures of reading about Christopher Marlowe is that it provides an antidote to the idolatry conferred on Shakespeare. David Riggs manages to write around 400 splendid pages about Elizabethan theatre while only briefly mentioning the favourite literary genius of the western world. The theatre was well established in London by the time that the lad from Stratford-upon-Avon arrived. It was served by numerous writers, some of them providing pot-boilers, some such as Thomas Kyd ("The Spanish Tragedy") extraordinarily gifted, and all constantly in demand to provide new scripts to fill the city's booming theatres.

Marlowe was king of this company, the greatest playwright that England had yet produced, the author of crowd-pullers such as "Dr Faustus" and "Tamberlaine", and the composer of "Come live with me and be my love", the most popular lyric of its time. Marlowe had the knack of combining literary excellence with enough violence to satisfy the crowd. Then he died in 1593, apparently in a pub brawl, aged only 29. Few likenesses of him survive. One possible candidate is in Corpus Christi College, Cambridge.

Had he lived and continued to write his mighty lines, would Marlowe, not Shakespeare, now be remembered as the foremost marvel of the age? It has to be said that this is not a question that bothers Rodney Bolt in his quirky book "History Play", perhaps best described as a scholarly joke. Mr Bolt is deeply suspicious of biographies of Shakespeare and Marlowe in which the few hard facts about their lives are "kneaded together with legend" and "a large dollop of the author's imagination".

He has taken the few known hard facts and shown how they can be used to construct a plausible story that is totally different from most biographies. Mr Bolt's Marlowe does not die in 1593. He lives for years on the run from his enemies, writing "Hamlet" and other fancies when he has a moment and getting Shakespeare, an opportunist with little literary talent, to market them for him.

All seemingly preposterous, agrees Mr Bolt: he is anxious not to be lumped in with the loonies who claim that Shakespeare was someone else. What is important to him, he says, is "how we construct truth", adding that "the book may very well have been called 'The Impossibility of Biography'."

Poor Shakespeare. It is not his fault that he is treated as an idol, or that he is mixed up with other celebrities who left their imprint on an extraordinarily showy age. Unlike the usual run of ruthless Elizabethans at every level of society up to the queen, he seems to have been a reasonably decent chap. He was happy to acknowledge that Marlowe showed the way forward in playwriting, pioneering blank verse, which Shakespeare was to use with increasing effect in his long series of history plays that tapped into Elizabethan patriotic fervour.

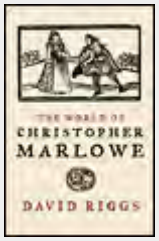
Mr Riggs says it is unlikely that Shakespeare ever met Marlowe but that he would have seen all his plays. In this sense Marlowe, although only two months older than Shakespeare, was his mentor. Years after Marlowe's death, when Shakespeare was writing "As You Like It", he had the notion of dropping into the play a well-known Marlowe line: "Who ever lov'd, that lov'd not at first sight", as a memorial to the

History Play: The Lives and Afterlife of Christopher Marlowe
By Rodney Bolt

HarperCollins; 388 pages; £17.99

Buy it at Amazon.co.uk

The World of Christopher Marlowe
By David Riggs



Faber and Faber; 432 pages; £12.99. To be published in America by Henry Holt in January 2005

Buy it at Amazon.co.uk

former master. All fantasy? Some will say so, others will enjoy the tale.

History Play: The Lives and Afterlife of Christopher Marlowe.
By Rodney Bolt.
HarperCollins; 388 pages; £17.99

The World of Christopher Marlowe.
By David Riggs.
Faber and Faber; 432 pages; £12.99. To be published in America by Henry Holt in January 2005

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Bad leaders

The neglected art of followership

Sep 2nd 2004
From The Economist print edition

MOST books about leadership are filled with examples of acknowledged masters—Alexander the Great is a perennial favourite. Of all the thousands of books written about Hitler, few focus on how his followers were so mesmerised by his leadership skills. It is almost as if what he practised was not worthy of the title “leadership”, an idea that has acquired powerfully positive connotations.

But it has traditionally been considered in isolation, as if the behaviour of followers were irrelevant. As a concept, “followership” scarcely exists. Now these two books by female academics, appearing almost at the same time, set out to rectify these biases. Leadership, says Jean Lipman-Blumen, a professor of organisational behaviour, should be viewed as “interaction between leaders and their followers”. It is the art of engaging and motivating others, driving them to actions, claims Barbara Kellerman, a professor of political science, that protects them against “the anxiety of disorder and the fear of death”. Compelling stuff indeed. But not necessarily beneficent. Leaders can be effective for a while without being good.

The authors produce a string of examples: Al “Chainsaw” Dunlap, the abusive boss of Sunbeam; Juan Antonio Samaranch, long-running president of the International Olympic Committee; Radovan Karadzic, the murderous leader of the Bosnian Serbs, trained in America as a psychiatrist; and Ken Lay, founder of Enron, once “the world's leading company”, who was reduced to going in and out of court in ignominy and handcuffs.

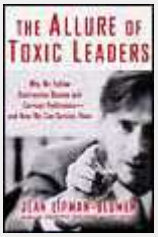
Ms Kellerman's book is more accessible to the general reader. She sets out a typology of bad leaders and identifies seven distinct categories: incompetent; rigid; intemperate; callous; corrupt; insular; and evil; and she tells interesting tales in defining Mr Samaranch as incompetent, Mr Dunlap as callous, and Mr Karadzic as cruel.

Ms Lipman-Blumen looks more at the psychology of followers. Why, she asks, do they allow themselves to be carried along by toxic leaders, sometimes even conspiring to keep those leaders in office? On occasions, her language is too fanciful. Leaders, she tells us, “assure us that we are not simply insignificant croutons tossed about on the salad of existence.” But the questions she raises are intriguing ones.

Once we acknowledge that bad leaders are bad for us, what can we do about them? One practical suggestion (from both authors) is that the tenure of leaders (whatever their field) be limited. Paraphrasing Lord Acton on absolute power, Ms Lipman-Blumen says “Endless power corrupts endlessly”. American presidents can run for no more than two terms, eight years in all. Why was J. Edgar Hoover allowed to lead the FBI for nearly half a century? Both authors recommend that leaders of all kinds be given the top job for a finite term before returning to the followers' fold for a dose of reality and reflection.

In an article in the latest issue of the influential *Harvard Business Review*—“Why People Follow the Leader: the Power of Transference”—Michael Maccoby, a psychoanalyst and management consultant, argues that followers are prisoners of the Freudian transference of childhood relationships into their adult life. It sounds as if a whole new field of academic study is just opening up: the art of followership.

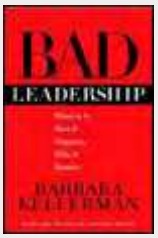
The Allure of Toxic Leaders: Why We Follow Destructive Bosses and Corrupt Politicians—and How We Can Survive Them
By Jean Lipman-Blumen



Oxford University Press; 303 pages; $30

Buy it at
Amazon.com
Amazon.co.uk

Bad Leadership: What It Is, How It Happens, Why It Matters
By Barbara Kellerman



Harvard Business School Press; 256 pages; $26.95

Buy it at
Amazon.com
Amazon.co.uk

The Allure of Toxic Leaders: Why We Follow Destructive Bosses and Corrupt Politicians—and How We Can Survive Them.
By Jean Lipman-Blumen.
Oxford University Press; 303 pages; $30

Bad Leadership: What It Is, How It Happens, Why It Matters.
By Barbara Kellerman.
Harvard Business School Press; 256 pages $26.95

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Antonio Stradivari

Lord of the strings

Sep 2nd 2004
From The Economist print edition

EVEN a tone-deaf trucker knows that the most famous, the most expensive, the most desired violin in the world today is a Stradivarius. But why should these 300-year-old instruments be so sought after? And why have they never been eclipsed? These two questions lie at the centre of Toby Faber's enlightening book about a man with magical hands.

Stradivarius: Five Violins, One Cello and a Genius
By Toby Faber

Macmillan; 294 pages; £16.99

Buy it at Amazon.co.uk

When Antonio Stradivari set up his workshop in the small northern Italian town of Cremona in the 1660s, the best-known violins were being made by the Amati family. Small, yet beautifully inlaid, the Amatis' sweet, contained tone was ideally suited to music for the court or the drawing-room. The violin, so human in range, so female in shape (as epitomised by Man Ray's 1924 photograph of a woman with a pair of S-shaped soundholes painted on her back), had already become the king of the orchestra. Catherine de Medici, who ordered a set of 38 stringed instruments, was an early buyer.

But by the 18th century, music-making was beginning to change. In order to make the violin project a rich, full tone to the very back of a music room and, eventually, of a concert hall, violin-making had to change too. Stradivari became the master of that metamorphosis, perfecting the varnishing of his instruments, seeking out better and bigger pieces of maple from which to cut violin backs in a single piece, and experimenting with incremental changes to the length of the soundbox and the arch of the belly. As George Eliot once wrote: “Tis God gives skill, but not without men's hands. He could not make Antonio Stradivari's violins without Antonio.”

The real delight of Mr Faber's book lies in his decision to tell the Stradivari story through the lives of six of the master's best-known instruments. One of them, known as the Messiah, a violin with a magnificent tiger-striped pattern on its back, was found in Stradivari's studio when he died in 1737.

A century later, it was in the hands of Luigi Tarisio, a peasant's son who, despite his humble background, was then in Paris telling the leading instrument-makers of the day, Jean-Baptiste Vuillaume and his son-in-law, Delphin Alard, about the existence of a perfect Stradivarius from the master's golden age. “So,” the exasperated Alard replied, “your violin is like the Messiah, always expected but never appearing.” Thus its name was born.

Vuillaume never forgot Tarisio's claims—of a Stradivarius violin that had not been altered or even played. When, by chance, he heard of the Italian's death, he collected together as much money as he could before heading for Italy and the smallholding where Tarisio's heirs lived. Guided by Tarisio's sister, Vuillaume began opening drawers in a piece of rickety furniture. There, in addition to five other masterpieces, he found the Messiah, which today is in the Ashmolean Museum in Oxford, where it is the only instrument to have its own showcase. It has never been played.

Reuters

Still filling halls with life three centuries after its birth

The other instruments in Mr Faber's book have, however, been played—by Paganini, Yehudi Menuhin and Tasmin Little (see above) among others. Each musician has tried to explain what they feel for them. But it is Ivry Gitlis, a less well-known name, who has perhaps put it best: “I have a violin that was born in 1713,” he wrote four years ago. “I don't consider it my violin. Rather, I am its violinist; I am passing though its life.”

Stradivarius: Five Violins, One Cello and a Genius.
By Toby Faber.
Macmillan; 294 pages; £16.99

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

New fiction

Room with a point of view

Sep 2nd 2004
From The Economist print edition

THERE are two things that Nicholson Baker does particularly well. He writes persuasive, real dialogue and he analyses the details of daily life with a surgeon's precision. In an earlier novel, for instance, he touchingly lamented the transition from paper to plastic straws.

Mr Baker's central concern has been the way such minute details—the texture of life—affect its underlying substance. So it is somewhat surprising that he has turned to an overtly political subject in his new novella, which contemplates the ethics of assassinating George W. Bush. The book is a transcript of a conversation between two childhood friends who have not seen each other for three years. The two sit in a hotel room in Washington, DC, where Jay, the putative assassin, justifies himself to Ben, who tries to dissuade him.

Jay is in the midst of a nervous breakdown. His wife left him, then his girlfriend left him and he has been unable to keep a steady job. He sports irrational beliefs about the efficacy of his weapons—intelligent bullets and radio-guided saw blades. However, he retains his cogency when making a political argument.

Checkpoint
By Nicholson Baker

Knopf; 115 pages; $15.95.
Chatto & Windus; £6.99

Buy it at
Amazon.com
Amazon.co.uk

None of this would work were it not for Mr Baker's fluency with dialogue, which suggests that the book is actually the transcript of a real conversation, a conversation that could easily be performed as a play. A key to this is the way he integrates commercial and technological realities of everyday life in America—blogs, chain stores and digital cameras, for example—into the conversation. And just as these aspects of the real world are integrated into the narrative, so Jay is not just plotting to kill a president; he is plotting to kill Mr Bush because of his anger at the invasion of Iraq and what he sees as the suborning of the democratic process.

Some critics have accused the book of being a call to action; but it is more a meditation on action. Many in America today feel for Jay's dilemma—is he right not to act, or is that just cowardice? How is moral responsibility distributed in a democracy? Naturally, in such a short work, Mr Baker raises more questions than he answers.

At one point, Ben suggests a calming exercise for Jay: “I say pick a book that you admire. Pick any book. Get a notebook and start copying it over. Copy the book from cover to cover.” Those quick to dismiss Mr Baker's work as incendiary should pick “Checkpoint” and start copying it now.

Checkpoint.
By Nicholson Baker.
Knopf; 115 pages; $15.95.
Chatto & Windus; £6.99

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Worldwide bestsellers

The big book index

Sep 2nd 2004
From The Economist print edition

Holiday reading when not on the beach

THIS month we take a look at the season's 15 bestselling travel books. Guides to Hawaii and Walt Disney World feature strongly, while Peter Mayle's "A Year in Provence" is still in the top ten, 13 years after it was first published—one of only two books on the list about the world's most popular tourist destination, France. Yet to appear is the delicious, though entirely fictitious "Molvania", a just-published travel guide to a land untouched by modern dentistry .

1. 11,000 Places to See Before You Die.
By Patricia Schultz. *Workman Publishing; 972 pages; $13.26 and £9.09*

An eclectic selection from a travel writer who suggests, inter alia, a safari in the Okavango Delta, a stay at the Hassler Hotel in Rome and a trip to the buddhas of Borobodur before that final trip we all of us must take.

Click to buy from Amazon.com or Amazon.co.uk

2. Ask the Pilot: Everything You Need to Know About Air Travel. By Patrick Smith. *Riverhead Books; 269 pages; $11.20 and £7.04*

An informative book written by someone you might want to sit next to on a commercial ight. He knows what all the strange noises are about.

Click to buy from Amazon.com or Amazon.co.uk

3. Maui Revealed: The Ultimate Guidebook.
By Andrew Doughty and Harriett Friedman. *Wizard Publications; 308 pages; $10.47 and £7.51*

A comprehensive guide to one of Hawaii's main attractions.

Click to buy from Amazon.com or Amazon.co.uk

4. The Ultimate Kauai Guidebook: Kauai Revealed.
By Andrew Doughty and Harriett Friedman. *Wizard Publications; 256 pages; $10.47 and £7.51*

Hawaii's north-west frontier from the couple responsible for number three on the list.

Click to buy from Amazon.com or Amazon.co.uk

5. The Unofficial Guide to Walt Disney World 2004.
By Bob Sehlinger. *John Wiley; 816 pages; $12.59 and £8.36*

Essential advice for those considering a visit to this theme park.

Click to buy from Amazon.com or Amazon.co.uk

6. Birnbaum's Walt Disney World 2004.
By Birnbaum. *Disney Editions; 256 pages; $11.87. Hyperion; £11.99*

Another guide to the world's most popular tourist attraction.

Click to buy from Amazon.com or Amazon.co.uk

7. Rick Steves' Italy 2004.
By Rick Steves. *Avalon Travel Publishing; 496 pages; $13.27 and £10.49*

Mr Steves is described as America's number one authority on travel around Europe.

Click to buy from Amazon.com or Amazon.co.uk

8. Hawaii: The Big Island Revealed.
By Andrew Doughty and Harriett Friedman. *Wizard Publications; 304 pages; $10.47 and £7.51*

A third bestselling guidebook to the Hawaiian islands from this prolific duo.

Click to buy from Amazon.com or Amazon.co.uk

9. A Year in Provence.
By Peter Mayle and Judith Clancy. *Vintage; 207 pages; $8.84. Penguin; £5.59*

A biographical account of an English couple who settle in the south of France. A perennial favourite, first published in 1991.

Click to buy from Amazon.com or Amazon.co.uk

10. A Walk in the Woods: Rediscovering America on the Appalachian Trail.
By Bill Bryson. *Broadway; 284 pages; $9.95. Black Swan; £6.39*

The humorous Bill Bryson tells of his 2,100-mile walk from Georgia to Maine.

Click to buy from Amazon.com or Amazon.co.uk

11. Lonely Planet Australia.
By Paul Smitz et al. *Lonely Planet Publications; 1056 pages; $19.71 and £11.89*

A guide for the cost-conscious traveller with plenty of time to read.

Click to buy from Amazon.com or Amazon.co.uk

12. PassPorter Walt Disney World Resort 2004: The Unique Travel Guide, Planner, Organizer, Journal and Keepsake.
By Jennifer Watson et al. *PassPorter Travel Press/ MediaMarx; 296 pages; $15.37 and £11.03*

Another Disney guide, this one complete with worksheets and expense forms.

Click to buy from Amazon.com or Amazon.co.uk

13. Fodor's Italy 2004.
By Matthew Lombardi. *Fodor's; 816 pages; $15.37 and £11.89*

Reliable instructions for visitors to the world's second-most-popular destination.

Click to buy from Amazon.com or Amazon.co.uk

14. Rick Steves' Paris 2004.
By Rick Steves. *Avalon Travel Publishing; 384 pages; $11.87 and £9.09*

A book that aims to make Paris accessible to those who hardly know it.

Click to buy from Amazon.com or Amazon.co.uk

15. Lonely Planet New Zealand.
By Carolyn Bain et al. *Lonely Planet Publications; 720 pages; $17.49 and £10.49*

The original backpacker's bible.

Click to buy from Amazon.com or Amazon.co.uk

Source: Global sales from Amazon.com, Amazon.co.uk, Amazon.ca, Amazon.de, Amazon.fr and Amazon.jp, from July 1st - August 31st. Prices are quoted from Amazon.com and Amazon.co.uk, and are correct as of September 1st.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

PRINTABLE PAGE VIEW SPONSORED BY

About sponsorship

Obituary

Elisabeth Kübler-Ross

Sep 2nd 2004
From The Economist print edition

AP

Elisabeth Kübler-Ross, explorer of death, died on August 24th, aged 78

THE first dead body Elisabeth Kübler-Ross ever saw was that of a neighbour in her village in Switzerland. He had died by falling out of a tree. In the living room of his house he lay in his bed, surrounded by family and friends. Elisabeth, then a child, was allowed to touch him; her father chatted to him, as though he were still alive.

That, Elisabeth decided then and there, was the proper way to deal with death. Even better was the Mexican way, camping on graves on the Día de los Muertos to picnic and make merry with the dead. But these were oddities. By the 20th century, acceptance of death as a part of life had been largely forgotten in western cultures. People no longer dared look death in the face, and no longer had to.

In America, as Dr Kübler-Ross found when she arrived at the Manhattan State Hospital in 1958, the dying were kept isolated, in distant wards where nurses did not have to hear their constant, hopeless ringing of the bell. Doctors viewed them as failures in an age where every infection and disease seemed to have found its cure. Few wanted to talk to them, for if there was no good prognosis there seemed nothing honest to say. Even their pain was indifferently dealt with, in case they were turned into opiate addicts in their final days.

Dr Kübler-Ross set out to change this. In 1967, now an assistant professor of psychiatry at the University of Chicago Medical School, she began to bring dying patients to her seminars. The students, shocked and embarrassed, would mumble polite questions about treatment; the dying, full of passion and anger, spoke of the weddings and children they would never have. Next, Dr Kübler-Ross gathered the students to watch, through one-way glass, as she encouraged terminal patients to say what they felt about death. Some could not watch at all, but ran away.

Two years later these interviews became a book, “On Death and Dying”, which made Dr Kübler-Ross both famous and influential. In it, she listed five stages through which, in her experience, the dying passed. The first was denial; the second, anger; the third, bargaining, in which the patient tried to do his best to extend the time left to him; the fourth, depression, when the bargain failed to work; and the fifth, stoical acceptance.

More important, however, than these stages—which seemed, to some, too arbitrary, and likely to delude patients that death was within their control—was her argument for better treatment of the dying. By forcing the American medical establishment to look at death, Dr Kübler-Ross did more than anyone else to push forward the hospice movement, living wills, proper palliative care and the notion of death with dignity (though she passionately opposed euthanasia, and refused when her own mother asked her to help her die). In so far as anyone could, she made death better. It ought, she said, to be “one of the greatest experiences ever”.

Beyond the pale

Most doctors would have stopped there. But Dr Kübler-Ross—the first of triplets, and all her life a tiny bundle of furious opinions expressed in a thick Swiss accent—decided also to disseminate her views of the after-life. These were more strongly felt than anything else. As a young woman, travelling through post-war Europe to help rebuild clinics, she had visited the Majdanek concentration camp in Poland. There she found the walls covered with drawings of butterflies, scratched by children who were about to be sent to the gas chambers. This, she surmised, was what death meant to them: the shedding of the unlamented body and the release of the spirit to a higher, better life.

Science, and scientific method, did not agree. Though poets and philosophers might write ardently of the soul and of immortality, doctors could not possibly describe these as “fact”. Plato, Plotinus and Shelley might describe the winged spirit struggling from the body, and “the abode where the Eternal are”; but scientists, however hazy their understanding of human consciousness, could have no truck with theories based neither on reason nor on observable evidence. Her colleagues increasingly murmured about Dr Kübler-Ross, and edged away.

Disastrously, she then went much further. She began to fill her lectures with tales of her out-of-the body experiences, including travelling through space at the speed of light. She fell in with Jay Barham, a charlatan from Arkansas who practised “channelling”, “spiritual cloning” and batty sorts of religio-sexual therapy. Four “spooks” from the spirit world called Salem, Ankh, Mario and Willie became her guides and mentors. Her husband, horrified by her antics, divorced her. By the 1980s her healing centres in Virginia and California were being shot at and burned down. Although the best parts of her work had taken hold—there are now more than 2,500 hospices in America—her reputation was in ruins.

Nor was her own death easy. Weakened by strokes, she lingered for years. Although she had moved to the Arizona desert, the sun now gave her seizures; she would sit in a dark room for 18 hours a day, watching television with the sound turned off. She railed at God for keeping her waiting. Impatiently, she filled her house with pictures and cabinets of butterflies.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Sep 2nd 2004
From The Economist print edition

Oil prices fell to just over $42 a barrel, down almost 15% from their mid-August highs.

America's GDP growth in the second quarter was revised downwards to 2.8% at an annual rate, down from 3.0% in the earlier estimate. In the year to the second quarter, America's economy grew by 4.7%, according to the latest estimate, down from 4.8%. The Institute for Supply Management's manufacturing index fell by more than expected, to 59.0 in August from 62.0 in July. Consumer confidence in August, as measured by the Conference Board's index, dropped to 98.2 from 105.7 in July.

America's inflation, according to the personal consumption expenditure (PCE) measure, a figure closely watched by the Fed, held steady in the year to July at 2.4%.

Japan's figures were disappointing. Unemployment rose to 4.9% in July, up from 4.6% in June. Industrial production was unchanged in July compared with June, and the year-on-year rise in industrial output fell to 5.9% in July from 8.9% in June.

Australia's economy grew by 4.1% in the year to the second quarter, and first-quarter growth was revised up to 3.6% year on year, from 3.2%.

In the second quarter, **Canada's** economy grew by 3.0% year on year, up from 1.6% in the first quarter.

The **euro area's** economy is struggling to gain traction. **Spain's** GDP growth fell to 2.6% in the year to the second quarter, down from 2.7% in the year to the first quarter. Unemployment in **France** edged down to 9.8% in July from 9.9% in June. Consumer prices in the euro area grew by 2.3% in the year to August, unchanged from the year to July. In **Italy**, the CPI also grew in August at the same year-on-year rate as in July, but producer prices edged up slightly in the year to July to 3.3%, from 3.2% in the year to June. Retail sales in Italy grew by 2.0% by value year on year in June, after falling in May. **Germany's** retail sales also grew in July, by 0.9% month on month. But sales are still below their level of a year ago. German business sentiment, as measured by the IFO index, declined slightly in August to 95.3 from 95.6 in July.

In **Switzerland**, inflation edged up slightly to 1.0% in the year to August thanks to rising energy prices, compared with 0.9% in the year to July.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Output, demand and jobs

Sep 2nd 2004
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2004	2005	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		Unemployment % rate year ago
Australia	+ 4.1	Q2	+ 2.5	+ 3.5	+ 3.3	– 1.1	Q1	+ 7.9	Q2	5.7	Jul	6.2
Austria	+ 0.5	Q1	+ 0.8	+ 1.6	+ 2.1	+ 6.6	May	– 4.7	May	4.2	Jul	4.5
Belgium	+ 2.8	Q2	+ 3.2	+ 2.2	+ 2.1	+ 2.7	Jun	– 2.5	May	12.8	Jul†	13.0
Britain	+ 3.7	Q2	+ 3.8	+ 3.3	+ 2.7	+ 0.5	Jun	+ 6.6	Jul	4.8	Jun††	5.0
Canada	+ 3.0	Q2	+ 4.3	+ 2.9	+ 3.4	+ 5.0	Jun	+ 3.1	Jun	7.2	Jul	7.7
Denmark	+ 2.5	Q2	+ 0.9	+ 2.0	+ 2.2	+ 3.9	Jun	+ 4.9	Jul	6.2	Jul	6.0
France	+ 2.8	Q2	+ 3.2	+ 2.2	+ 2.2	+ 2.7	Jun	+ 4.1	Jun	9.8	Jul	9.8
Germany	+ 2.0	Q2	+ 1.9	+ 1.5	+ 1.7	+ 2.7	Jun	nil	Jul	10.6	Aug§	10.6
Italy	+ 1.1	Q2	+ 1.0	+ 1.2	+ 1.8	– 0.1	Jun	– 5.3	May	8.5	Jan	8.9
Japan	+ 4.4	Q2	+ 1.7	+ 4.5	+ 2.3	+ 5.9	Jul	– 2.9	Jun	4.9	Jul	5.3
Netherlands	+ 1.0	Q2	– 0.8	+ 1.3	+ 1.8	nil	Jun	– 1.0	May‡	6.3	Jul**	5.3
Spain	+ 2.6	Q2	+ 2.0	+ 2.8	+ 2.8	+ 5.7	Jun	+ 2.1	Jun	11.0	Jul	11.3
Sweden	+ 3.4	Q2	+ 3.8	+ 2.8	+ 2.6	+ 3.4	Jun	+ 4.3	Jun	5.6	Jul†	5.0
Switzerland	+ 1.5	Q1	+ 1.6	+ 1.9	+ 2.1	+ 4.5	Q1	+ 6.2	Jun	3.6	Jul†	3.6
United States	+ 4.7	Q2	+ 2.8	+ 4.5	+ 3.5	+ 4.9	Jul	+ 5.6	Jun	5.5	Jul	6.2
Euro area	+ 2.0	Q2	+ 2.0	+ 1.8	+ 2.0	+ 2.7	Jun	+ 1.2	Jun	9.0	Jul	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 2.7	Q1	+ 3.0	na	na	+ 7.8	Jul	+ 3.4	Jun	7.8	Jul†	7.9
Greece	+ 3.9	Q2	– 0.6	na	na	– 1.5	Jun	+ 4.0	May	na		na
Iceland	+ 4.9	Q1	na	na	na	na		na		3.1	Jun†	3.2
Ireland	+ 6.1	Q1	na	na	na	+ 4.2	Jun	+ 3.3	Jun	4.4	Jul	4.8
Luxembourg	+ 2.1	2003	na	na	na	– 1.2	Dec	+ 2.3	Mar	3.9	Jun	3.5
New Zealand	+ 4.4	Q1	+ 8.1	na	na	+ 5.5	Q1	+ 6.8	Q2	4.0	Q2	4.7
Norway	+ 2.9	Q1	+ 3.9	na	na	+10.4	Jun	+ 5.3	Jun	4.6	Q2	4.7
Portugal	+ 0.1	Q1	+ 2.4	na	na	– 3.4	Jul	+ 5.2	Jun	6.3	Q2†	6.1

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡New series. ††Apr-Jun; claimant count rate 2.7% in Jul. §EU harmonised rate 9.9% in Jul. **May-Jul.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Prices and wages

Sep 2nd 2004
From The Economist print edition

% change on year ago

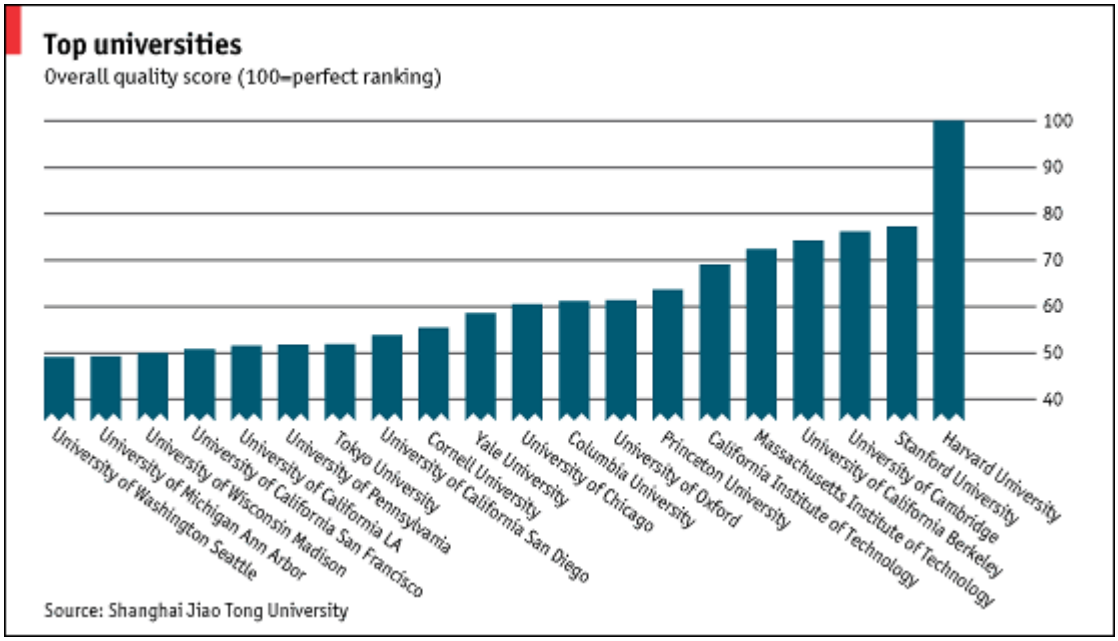
	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2004	2005	latest		year ago	latest		year ago
Australia	+ 2.5	Q2	+ 2.7	+ 2.5	+ 2.5	+ 2.8	Q2	+ 0.2	+ 2.9	Q2	+ 5.5
Austria	+ 2.3	Jul	+ 1.1	+ 1.6	+ 1.5	+ 6.0	Jul	+ 1.2	+ 2.2	Jun	+ 2.1
Belgium	+ 2.4	Jul	+ 1.5	+ 1.8	+ 1.6	+ 5.3	Jul	– 1.3	+ 2.3	Apr	+ 1.7
Britain	+ 1.4	Jul*	+ 1.3	+ 1.5	+ 1.8	+ 2.5	Jul	+ 1.3	+ 4.4	Jun†	+ 3.0
Canada	+ 2.3	Jul	+ 2.2	+ 2.0	+ 2.1	+ 6.4	Jun	– 2.7	+ 2.6	May	+ 3.0
Denmark	+ 1.3	Jul	+ 1.9	+ 1.3	+ 1.9	+ 2.7	Jul	– 0.1	+ 3.3	Q1	+ 3.9
France	+ 2.3	Jul	+ 1.9	+ 2.1	+ 1.7	+ 2.2	Jun	+ 0.9	+ 2.8	Q1	+ 2.9
Germany	+ 2.0	Aug	+ 1.1	+ 1.6	+ 1.2	+ 3.9	Jul	nil	+ 1.4	Jun	+ 2.0
Italy	+ 2.3	Aug	+ 2.8	+ 2.3	+ 2.1	+ 3.3	Jul	+ 1.3	+ 3.2	Jul	+ 2.1
Japan	– 0.1	Jul	– 0.2	– 0.1	+ 0.3	+ 1.6	Jul	– 0.8	+ 0.8	Jun	+ 4.0
Netherlands	+ 1.1	Jul	+ 2.1	+ 1.5	+ 1.4	+ 3.7	Jun	+ 1.2	+ 1.2	Jul	+ 2.6
Spain	+ 3.4	Jul	+ 2.8	+ 2.8	+ 2.6	+ 4.1	Jul	+ 1.1	+ 3.2	Q1	+ 4.9
Sweden	+ 0.7	Jul	+ 1.8	+ 0.8	+ 1.6	+ 1.9	Jul	– 1.5	+ 1.1	Jun	+ 3.5
Switzerland	+ 1.0	Aug	+ 0.5	+ 0.7	+ 1.1	+ 1.3	Jul	– 0.7	+ 1.4	2003	+ 1.8
United States	+ 3.0	Jul	+ 2.1	+ 2.6	+ 2.3	+ 4.0	Jul	+ 2.9	+ 1.9	Jul	+ 2.9
Euro area	+ 2.3	Aug	+ 2.1	+ 2.0	+ 1.7	+ 2.4	Jun	+ 1.4	+ 2.5	Q1	+ 3.0
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.3	Jul	+ 0.4	na	na	+ 1.5	Jul	– 0.4	+ 3.5	Q2	+ 4.4
Greece	+ 2.9	Jul	+ 3.6	na	na	+ 1.9	Jun	+ 3.1	na		na
Iceland	+ 3.7	Aug	+ 2.0	na	na	+ 5.2	Jul	+ 3.3	+ 5.1	Jul	+ 5.7
Ireland	+ 2.7	Jul	+ 3.1	na	na	– 0.7	Jul	– 8.2	+ 6.1	Q4	+ 6.4
Luxembourg	+ 2.4	Jul	+ 1.6	na	na	+ 9.0	Jun	+ 2.3	– 0.4	Dec	+ 0.7
New Zealand	+ 2.4	Q2	+ 1.5	na	na	+ 1.5	Q2	– 1.9	+ 2.3	Q2	+ 2.3
Norway	+ 1.5	Jul	+ 1.5	na	na	+13.6	Jul	+ 6.3	+ 4.6	Q1	+ 5.3
Portugal	+ 2.8	Jul	+ 2.9	na	na	+ 4.2	Jul	– 0.4	+ 1.3	May	– 1.9

*New series. RPI inflation rate 3.0% in Jul. †Apr-Jun.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Top universities

Sep 2nd 2004
From The Economist print edition



Harvard again leads the ranking of 500 universities compiled at Shanghai Jiao Tong University. Of the world's top 20 universities, all but three—Cambridge, Oxford and Tokyo—are in the United States. The ranking relies on several measures of research performance and academic quality, including academic citations. These techniques are biased against universities focusing on the humanities and social sciences.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Money and interest rates

Sep 2nd 2004
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Sep 1st 2004)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 5.5	+12.0	Jul	5.43	4.86	5.20	5.50	5.66	6.27
Britain	+ 5.6	+ 8.8	Jul	4.91	3.63	4.78	4.92	4.75	5.67
Canada	+10.8	+ 7.4	Jul	2.20	2.69	2.94	4.61	4.97	6.17
Denmark	+ 8.4	+10.3	Jul	2.15	2.30	2.39	4.12	4.51	5.42
Japan	+ 4.0	+ 1.9	Jul	0.03	0.01	0.13	1.56	1.63	1.66
Sweden	+ 1.5	+ 2.3	Jul	2.00	2.70	2.76	4.33	4.77	2.83
Switzerland	+ 3.8	+ 3.0	Jul	0.65	0.27	1.05	2.61	2.88	2.37
United States	+ 4.0	+ 4.8	Jul	1.65	1.04	2.37	4.12	4.60	5.68
Euro area†	+10.1	+ 5.5	Jul	2.12	2.16	2.45	3.99	4.32	3.77

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. † Germany for bonds. Benchmarks: US 30-year 4.93%, Japan No. 262 1.51%. Central bank rates: US fed funds 1.50%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.75%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Economist commodity price index

Sep 2nd 2004
From The Economist print edition

1995=100

	Aug 24th	Aug 31st*	% change on one month	% change on one year
Dollar index				
All items	90.5	90.2	+ 0.4	+12.2
Food	84.6	84.0	+ 0.3	+ 5.3
Industrials				
All	98.6	98.5	+ 0.5	+21.4
Nfa†	92.6	93.3	+ 3.5	+ 8.3
Metals	103.7	102.9	- 1.8	+33.7
Sterling index				
All items	79.5	79.1	+ 1.7	- 2.0
Euro index				
All items	98.2	97.6	- 0.4	+ 0.3
Yen index				
All items	105.5	105.3	- 0.4	+ 5.9
Gold				
$ per oz	405.43	410.23	+ 4.8	+ 9.9
West Texas Intermediate				
$ per barrel	45.21	42.15	- 4.4	+42.5

* Provisional. † Non-food agriculturals.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Stockmarkets

Sep 2nd 2004
From The Economist print edition

Market indices

	Sep 1st	2004 high	2004 low	% change on one week	% change on record high	% change on Dec 31st 2003 in local currency	% change on Dec 31st 2003 in $ terms
Australia (All Ordinaries)	3,581.6	3,581.6	3,274.9	+ 1.5	nil	+ 8.3	+ 1.2
Austria (ATX)	2,001.7	2,047.0	1,568.9	+ 1.0	- 2.2	+29.5	+25.0
Belgium (Bel 20)	2,584.5	2,584.5	2,244.2	+ 2.2	-29.8	+15.2	+11.1
Britain (FTSE 100)	4,502.1	4,575.7	4,287.0	+ 2.0	-35.0	+ 0.6	+ 0.8
Canada (Toronto Composite)	8,410.1	8,898.8	8,123.5	+ 0.5	-26.2	+ 2.3	+ 1.1
Denmark (KBX)	241.1	241.3	219.0	+ 1.3	-20.1	+12.9	+ 9.0
France (SBF 250)	2,469.8	2,594.4	2,386.1	+ 0.4	-43.7	+ 2.4	- 1.2
(CAC 40)	3,613.2	3,811.4	3,465.3	+ 0.5	-47.8	+ 1.6	- 2.0
Germany (DAX)	3,817.6	4,151.8	3,647.0	+ 0.8	-52.7	- 3.7	- 7.1
Italy (BCI)	1,284.8	1,340.3	1,239.5	+ 1.0	-41.1	+ 2.2	- 1.3
Japan (Nikkei 225)	11,127.4	12,163.9	10,365.4	nil	-71.4	+ 4.2	+ 2.0
(Topix)	1,135.6	1,217.9	1,022.6	+ 0.6	-60.6	+ 8.8	+ 6.5
Netherlands (AEX)	325.3	364.8	310.7	+ 1.0	-53.6	- 3.7	- 7.0
Spain (Madrid SE)	839.4	881.7	804.4	+ 1.9	-26.8	+ 3.9	+ 0.3
Sweden (Affarsvarlden Gen)	203.0	218.1	188.5	+ 1.2	-49.3	+ 7.8	+ 3.4
Switzerland (Swiss Market)	5,468.0	5,934.4	5,309.8	+ 1.7	-35.0	- 0.4	- 2.5
United States (DJIA)	10,168.5	10,737.7	9,814.6	- 0.1	-13.3	- 2.7	- 2.7
(S&P 500)	1,105.9	1,157.8	1,063.2	+ 0.1	-27.6	- 0.5	- 0.5
(NASDAQ Comp)	1,850.4	2,153.8	1,752.5	- 0.6	-63.3	- 7.6	- 7.6
Europe (FTSE Eurotop 300)*	977.0	1,026.2	940.9	+ 1.2	-42.7	+ 2.0	- 1.6
Euro area (FTSE Ebloc 100)*	820.5	888.3	787.2	+ 1.0	-47.1	- 1.3	- 4.8
World (MSCI)†	1,034.3	1,085.8	997.0	+ 0.7	-28.6	- 0.2	- 0.2
World bond market (Citigroup)‡	606.3	619.5	575.1	nil	- 3.0	- 0.4	- 0.4

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms.
‡Citigroup World Government Bond Index, total return, in $ terms.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Trade, exchange rates and budgets

Sep 2nd 2004
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2004	Current account The Economist poll % of GDP, forecast 2005	Exchange rate trade-weighted† 1990=100 Sep 1st	Exchange rate trade-weighted† 1990=100 year ago	Currency units per $ Sep 1st	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2004‡
Australia	− 16.8 Jul	− 34.2 Q2	− 5.4	− 3.9	83.3	81.3	1.42	1.56	2.55	1.73	1.30	0.5
Austria	− 0.1 May	− 1.5 Jun	− 0.4	− 0.2	102.8§	103.1	0.82	0.92	1.47	–	0.75	-1.3
Belgium	+ 20.8 Jun	+ 12.2 Mar	+ 3.5	+ 3.4	102.9§	103.3	0.82	0.92	1.47	–	0.75	-0.2
Britain	− 93.6 Jun	− 39.2 Q1	− 2.4	− 2.0	103.6	99.5	0.56	0.64	–	0.68	0.51	-2.9
Canada	+ 50.0 Jun	+ 23.8 Q2	+ 2.2	+ 1.6	88.3	84.8	1.31	1.39	2.35	1.59	1.19	1.2
Denmark	+ 10.2 Jun	+ 7.1 Jun	+ 2.7	+ 2.6	106.4	105.5	6.11	6.86	11.0	7.44	5.58	0.9
France	+ 3.7 Jun	+ 0.7 Jun	+ 0.7	+ 0.8	106.3§	106.8	0.82	0.92	1.47	–	0.75	-3.8
Germany	+186.4 Jun	+ 93.7 Jun	+ 2.8	+ 2.6	104.0§	104.5	0.82	0.92	1.47	–	0.75	-3.7
Italy	+ 3.4 May	− 14.5 Jun	− 1.0	− 0.8	75.9§	76.1	0.82	0.92	1.47	–	0.75	-3.1
Japan	+128.9 Jun	+163.6 Jun	+ 3.5	+ 3.6	134.7	134.0	109	116	196	133	–	-7.1
Netherlands	+ 33.5 Jun	+ 20.7 Q2	+ 2.8	+ 2.8	102.4§	102.8	0.82	0.92	1.47	–	0.75	-3.1
Spain	− 62.4 Jun	− 30.0 May	− 2.9	− 2.6	77.0§	77.4	0.82	0.92	1.47	–	0.75	0.3
Sweden	+ 22.7 Jul	+ 23.4 Q2	+ 6.4	+ 5.8	81.3	80.1	7.50	8.42	13.5	9.13	6.85	0.2
Switzerland	+ 8.3 Jul	+ 37.5 Q1	+10.5	+10.2	112.8	111.5	1.26	1.42	2.27	1.54	1.15	-1.6
United States	−589.5 Jun	−537.3 Q1	− 5.2	− 4.4	96.7	105.3	–	-	1.79	1.22	0.91	-4.7
Euro area	+110.8 Jun	+ 59.7 Jun	+ 0.5	+ 0.6	90.6	87.4	0.82	0.92	1.47	–	0.75	-2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 14.5 Jun	+ 10.6 Jun	na	na	81.9§	82.2	0.82	0.92	1.47	–	0.75	1.6
Greece	− 27.8 Jun	− 9.3 Jun	na	na	59.5§	59.7	0.82	0.92	1.47	–	0.75	-3.2
Iceland	− 0.4 Jul	− 0.7 Q1	na	na	95.2**	98.2	72.2	81.7	130	87.9	66.0	0.2
Ireland	+ 41.8 Jun	− 2.1 Q1	na	na	93.9§	95.2	0.82	0.92	1.47	–	0.75	-0.5
Luxembourg	− 3.9 May	+ 3.2 Q1	na	na	102.9§	103.3	0.82	0.92	1.47	–	0.75	-1.8
New Zealand	− 2.1 Jul	− 3.4 Q1	na	na	105.3	97.7	1.52	1.76	2.73	1.85	1.39	2.9
Norway	+ 30.1 Jul	+ 29.4 May	na	na	96.2	96.5	6.86	7.60	12.3	8.35	6.27	10.4
Portugal	− 15.8 May	− 9.3 Jun	na	na	93.3**	92.9	0.82	0.92	1.47	–	0.75	-3.8

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, June average. ‡OECD forecast. **IMF, April average.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

The Economist commodity price index

Sep 2nd 2004
From The Economist print edition

Our all-items index has fallen by 10% from its seven-year high in March and is now only 1% above its level at the beginning of the year. Food prices have fallen by 16% since March. Metal prices are 5% below their April high.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Overview

Sep 2nd 2004
From The Economist print edition

Hong Kong's economy is heating up. GDP grew by 12.1% in the year to the second quarter, compared with 7.0% in the year to the first quarter. In the **Philippines**, GDP grew by 0.7% in the second quarter, but slowed to 6.2% year on year.

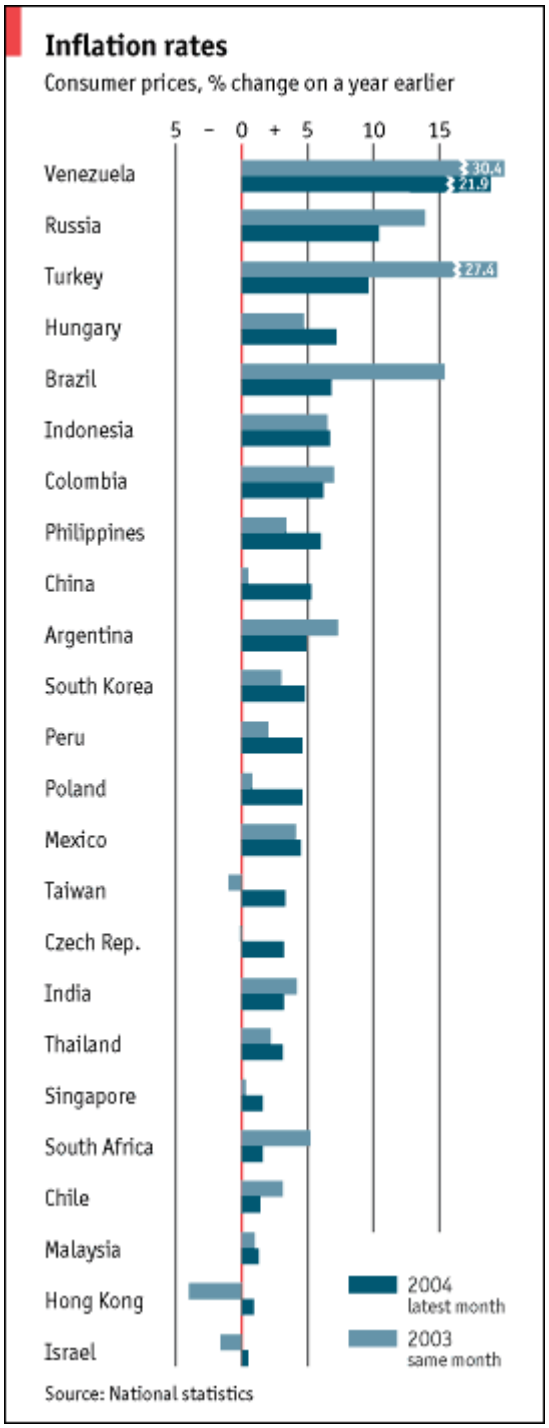
South Africa's economic growth in the year to the second quarter reached 2.5%, thanks partly to lower interest rates. During the same period, **Brazil's** GDP rose by 5.7%.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Inflation rates

Sep 2nd 2004
From The Economist print edition

Over the past year, inflation has eased in those emerging economies that have recently suffered its worst effects. In Venezuela, consumer-price inflation slowed to 21.9% from 30.4% a year ago. The inflation rate fell by more than half in Brazil. Argentina, whose consumer prices grew by 41% in 2002, has seen inflation fall to 4.9%. In China and the Philippines, however, inflation has risen above 5%. In Hungary, it rose to 7.2%.



Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Economy

Sep 2nd 2004
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.6	Q2	+15.5	Jul	+ 5.3	Jul	+15.7	Jul	+45.9	2003	470.6	Jun
Hong Kong	+12.1	Q2	+ 1.8	Q1	+ 0.9	Jul	−13.4	Jul	+14.8	Q1	118.3	Jul
India	+ 8.2	Q1	+ 7.3	Jun	+ 3.2	Jul	−18.1	Jul	+ 8.7	Q1	113.0	Jul
Indonesia	+ 4.3	Q2	+15.0	Jun	+ 6.7	Aug	+24.8	Jul	+ 3.9	Q2	33.7	Jun
Malaysia	+ 8.0	Q2	+13.3	Jun	+ 1.3	Jul	+20.1	Jul	+13.0	Q1	54.3	Jul
Philippines	+ 6.2	Q2	+ 2.7	Jun	+ 6.0	Jul	− 1.5	Jun	+ 3.9	Mar	12.8	Jul
Singapore	+12.5	Q2	+19.0	Jul	+ 1.6	Jul	+15.7	Jul	+28.4	Q2	100.3	Jul
South Korea	+ 5.5	Q2	+12.8	Jul	+ 4.8	Aug	+29.2	Aug	+27.5	Jul	167.9	Jul
Taiwan	+ 7.7	Q2	+ 9.5	Jul	+ 3.3	Jul	+12.7	Jul	+25.8	Q2	230.4	Jul
Thailand	+ 6.5	Q1	+ 9.3	Jul	+ 3.1	Aug	+ 1.8	Jul	+ 7.2	Jul	42.4	Jul
Argentina	+10.7	Q1	+ 8.3	Jul	+ 4.9	Jul	+12.8	Jul	+ 6.1	Q1	18.1	Jul
Brazil	+ 5.7	Q2	+13.0	Jun	+ 6.8	Jul	+31.7	Aug	+ 9.2	Jul	49.8	Jun
Chile	+ 5.1	Q2	+ 5.8	Jul	+ 1.4	Jul	+ 6.7	Jul	+ 1.2	Q2	15.9	Jun
Colombia	+ 4.3	Q2	+11.7	Jun	+ 6.2	Jul	+ 0.2	Apr	− 1.6	Q1	11.6	Jun
Mexico	+ 3.9	Q2	+ 5.2	Jun	+ 4.5	Jul	− 5.7	Jul	− 6.7	Q2	60.4	Jun
Peru	+ 3.0	Jun	+ 7.5	Jun	+ 4.6	Jul	+ 1.5	Jun	− 0.7	Q2	10.3	Jul
Venezuela	+13.6	Q2	+32.2	Jun	+21.9	Aug	+20.3	Q2	+14.0	Q2	18.9	May
Egypt	+ 3.1	2003†	+ 2.6	2003†	+16.5	May‡	− 6.7	Q1	+ 3.9	Q1	13.3	May
Israel	+ 3.0	Q2	+11.0	Jun	+ 0.5	Jul	− 5.3	Jul	+ 0.3	Q1	26.2	Jul
South Africa	+ 2.5	Q2	+ 4.9	Jun	+ 1.6	Jul	− 0.2	Jul	− 2.0	Q1	10.3	Jul
Turkey	+10.1	Q1	+15.7	Jun	+ 9.6	Jul	−30.3	Jul	−12.1	Jun	33.9	Jun
Czech Republic	+ 3.1	Q1	+15.1	Jun	+ 3.2	Jul	− 2.3	Jun	− 6.0	Q1	26.3	Jul
Hungary	+ 4.0	Q2	+ 8.7	Jun	+ 7.2	Jul	− 3.7	Apr	− 8.4	Apr	12.8	Jul
Poland	+ 6.9	Q1	+ 6.0	Jul	+ 4.6	Jul	− 5.5	Jun	− 3.6	Jun	34.6	Jul
Russia	+ 7.4	Q1	+ 4.4	Jul	+10.4	Jul	+69.0	Jul	+38.4	Q2	84.9	Jul
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 6.8	Q1	+ 6.3	Jul	+ 4.1	Jul	− 2.5	Jun	− 1.2	Q1	1.3	Jun
Latvia	+ 8.8	Q1	+ 7.3	Jun	+ 6.7	Jul	− 2.5	Jun	− 1.4	Jun	1.5	Jun
Lithuania	+ 6.9	Q2	na		+ 1.9	Jul	− 3.0	Jun	− 1.5	Q1	3.2	Jun
Slovakia	+ 5.5	Q1	+ 4.7	Jun	+ 8.5	Jul	− 0.7	Jun	− 0.4	May	11.9	Jun
Slovenia	+ 3.7	Q1	+ 9.6	Jun	+ 3.7	Aug	− 0.9	Jun‡	− 0.2	Jun	8.2	May
Pakistan	+ 5.1	2003†	+ 3.3	Mar	+ 9.3	Jul	− 3.4	Jul	+ 1.8	Q2	11.2	Jun
Saudi Arabia	+ 7.2	2003	na		+ 0.4	May	+61.2	2003	+29.7	2003	21.9	Jun

*Excluding gold, except Singapore; IMF definition. †Year ending June. ‡New series, % change Jan-May annualised.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.

Financial markets

Sep 2nd 2004
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Sep 1st		Dec 31st 2003	
	Sep 1st	year ago	Sep 1st	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	14.8	3.50	1,386.4	−1.4	− 11.6	− 11.6
Hong Kong	7.80	7.80	14.0	0.83	13,023.9	+1.8	+ 3.6	+ 3.1
India	46.3	45.9	83.1	4.69	5,210.9	+2.4	− 10.8	− 12.1
Indonesia	9,324	8,465	16,724	7.49	775.1	+5.9	+ 12.0	+ 1.2
Malaysia	3.80	3.80	6.82	2.87	828.4	+2.6	+ 4.3	+ 4.3
Philippines	56.2	54.7	100.9	7.63	1,592.7	+2.9	+ 10.4	+ 9.0
Singapore	1.71	1.76	3.06	1.31	1,929.5	+0.6	+ 9.3	+ 8.7
South Korea	1,150	1,174	2,063	3.52	817.4	+1.7	+ 0.8	+ 4.5
Taiwan	33.9	34.1	60.7	1.10	5,858.1	+3.5	− 0.6	− 0.3
Thailand	41.6	40.8	74.6	1.68	628.8	+3.5	− 18.6	− 22.5
Argentina	3.00	2.98	5.37	5.50	962.7	+2.2	− 10.2	− 12.1
Brazil	2.93	2.95	5.26	15.91	22,512.0	−2.4	+ 1.2	− 0.3
Chile	627	692	1,125	1.68	8,243.1	+1.5	+ 12.4	+ 6.1
Colombia	2,533	2,827	4,543	7.80	3,138.2	+6.6	+ 34.5	+ 47.6
Mexico	11.4	10.9	20.4	7.29	10,329.8	+0.9	+ 17.4	+ 15.8
Peru	3.37	3.48	6.04	2.44	2,843.0	−0.1	+ 16.8	+ 20.0
Venezuela	2,684§	1,598	4,815	12.24	27,359.0	+5.1	+ 23.2	+ 30.9
Egypt	6.23	6.13	11.18	10.93	17,273.8	+2.5	+ 48.4	+ 46.8
Israel	4.51	4.44	8.10	1.00	547.3	−0.9	+ 2.4	− 0.3
South Africa	6.63	7.30	11.9	7.50	11,145.1	+1.6	+ 7.3	+ 8.1
Turkey	1,507,000	1,392,500	2,703,106	24.20	20,512.2	+4.9	+ 10.1	+ 2.7
Czech Republic	26.1	29.9	46.9	2.65	817.6	+2.7	+ 24.0	+ 21.9
Hungary	204	237	366	11.11	12,251.0	+2.1	+ 30.6	+ 32.8
Poland	3.65	4.02	6.55	7.09	24,306.2	+1.4	+ 16.7	+ 19.7
Russia	29.2	30.6	52.4	13.00	583.7‡	+4.5	+ 2.9	+ 2.9
EMF (MSCI)*	1.00	1.00	1.79	na	443.4	+2.2	+ 0.1	+ 0.1
EMBI+†	1.00	1.00	1.79	na	308.4	+0.6	+ 4.6	+ 4.6

*Emerging Mkts Free. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate.
Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Economist Intelligence Unit; Reuters; J.P. Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Akbank; Deutsche Bank.

Copyright © 2006 The Economist Newspaper and The Economist Group. All rights reserved.